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No. 08 _____

IN THE

Supreme Court of the United States

EL TORO MATERIALS COMPANY, INC. and KAREN SUE NAYLOR, CHAPTER 11 TRUSTEE

Petitioners,

v.

SADDLEBACK VALLEY COMMUNITY CHURCH,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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PETITION FOR WRIT OF CERTIORARI

Ronald K. Van Wert*
A Member of Ronald
K. Van Wert,
A Professional Corporation
3200 Park Center Dr,
Suite 1110
Costa Mesa, CA 92626
(714) 546-2400

Arturo M. Cisneros*
Donald W. Robinson
Malcolm ♦ Cisneros
2112 Business
Center Drive
Second Floor
Irvine, CA 92612
(949) 252-9400

**Counsel of Record* *Attorneys for Petitioners*

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QUESTIONS PRESENTED

Whether a lessor's tort claim for damages caused by a debtor-lessee's acts, including failure to remove debris, regrade, and restore leased premises, which acts also constitute a breach of its lease, are damages "resulting from" the rejection of the lease under § 502(b)(6) of the Bankruptcy Code.

Whether Bankruptcy Code § 502(b)(6) caps all damage claims of a lessor arising out of a debtor-lessee's rejection of a lease or merely caps claims for future rent.

PARTIES TO THE PROCEEDING

Petitioner El Toro Materials Company, Inc. ("El Toro") was the plaintiff in the bankruptcy court proceeding and, along with Petitioner Karen Sue Naylor, Chapter 11 Trustee, the appellee in the Ninth Circuit Court of Appeals below. El Toro is also the debtor in bankruptcy case SA 02-18913 ES pending in the United States Bankruptcy Court for the Central District of California, Santa Ana Division.

Respondent Saddleback Valley Community Church ("SVCC") was the defendant in the bankruptcy court proceeding and the appellant in the Court of Appeals.

CORPORATE DISCLOSURE STATEMENT

El Toro has no parent corporation. No publicly held corporation owns 10% or more of El Toro's stock.

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PETITION FOR WRIT OF CERTIORARI

Petitioners El Toro and Karen Sue Naylor, the Chapter 11 Trustee ("Trustee"), respectfully petition that a Writ of Certiorari be issued to review the judgment of the United States Court of Appeals for the Ninth Circuit.

DECISIONS BELOW

The decision of the United States Court of Appeals for the Ninth Circuit in *Saddleback Valley Community Church v. El Toro Materials, Inc. (In re El Toro Materials, Inc.)* is published at 504 F.3d 978 (9th Cir. 2007) and is contained in Appendix C, p. A-23. The order of the Court of Appeals denying rehearing and rehearing *en banc* is unreported and is contained in Appendix B, p. A-21. The decision of the Bankruptcy Appellate Panel of the Ninth Circuit is unreported and is set forth in Appendix D, p. A-37. The opinion of the United States Bankruptcy Court for the Central District of California is unreported and contained in Appendix E, p. A-82. The Bankruptcy Court's Order Granting In Part Debtor's Motion for Partial Summary Adjudication is contained in Appendix E, p. A-92.

JURISDICTION

The judgment of the Court of Appeals was entered on October 1, 2007. The court denied rehearing and *en banc* review on November 6, 2007. Appendix B, p. A-21. This Court has jurisdiction under 28 U.S.C.§158(d).

STATUTORY PROVISIONS

This Petition involves Bankruptcy Code §§ 365(a), 365(b)(1), 365(g)(1), 502(b)(6), and 502(g). 11 U.S.C. §§ 365, 502. The full text of Bankruptcy Code § 365 is set forth in Appendix A, pp. A-1-A-12. The full text of Bankruptcy Code § 502 is set forth in Appendix A, pp. A-12-A-20.

Bankruptcy Code § 365(a) provides:

> (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

11 U.S.C. § 365(a).[1]

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[1] Appendix A, p. A-1.

Bankruptcy Code § 365(b)(1) provides in pertinent part as follows:

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee--

> (A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real

property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

11 U.S.C. § 365(b)(1)[2]

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[2] Appendix A, pp. A-1-A-2.

Bankruptcy Code § 365(g)(1) provides:

> (g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—
>
> > (1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title immediately before the date of the filing of the petition ....

11 U.S.C. § 365(g).[3]

Bankruptcy Code § 502(b)(6) provides in pertinent part as follows:

> Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as

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[3] Appendix A, pp. A-10-A-11.

of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

> (6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—
>
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.

11 U.S.C. § 502(b)(6).[4]

Bankruptcy Code § 502(g) provides in pertinent part as follows:

(g) (1) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

11 U.S.C. § 502(g)(1).[5]

STATEMENT OF THE CASE

This petition seeks review of a decision by the Ninth Circuit Court of Appeals holding that: (1) a lessor's damages for the debtor's failure to repair and maintain the property, remove debris, and restore the property, do not arise upon termination or expiration of the lease or give rise to a claim for rejection damages; and (2) Congress did not intend

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[4] Appendix A, pp. A-12-A-14.
[5] Appendix A, pp. A-17-A-18.

to cap total damages resulting from the termination of a lease when it enacted Bankruptcy Code § 502(b)(6) but rather only damage claims for future rent.

The Ninth Circuit's determination that SVCC's damage claims did not result from the rejection of the lease conflicts with its own decision in *K-4, Inc. v. Midway Engineered Wood Products, Inc. (In re TreeSource Indus., Inc.)*, 363 F.3d 994 (9th Cir. 2004). Its interpretation of the scope of the Bankruptcy Code § 502(b)(6) cap conflicts with decisions by the Third and Sixth Circuits and is at odds with the unambiguous text of the statute, the legislative history, and pre-Code practice.

To the extent the Ninth Circuit's decision can be read to cap contract damages but not tort claims based on conduct that also breaches a lease, the Ninth Court has decided an important question of federal law that has not been, but should be, settled by this Court. The decision establishes a troubling precedent that will eviscerate Bankruptcy Code § 502(b)(6) and allow virtually every landlord to evade the cap on damages by the simple expedient of characterizing breaches of lease covenants as torts.

A. Statement of Facts

Since the 1960s, El Toro or its predecessor conducted sand and gravel mining operations on leased property in the City of Lake Forest, Orange County, California. Appendix D (BAP Memorandum), pp. A-39-A-40. Baker Ranch Properties ("Baker Ranch") had owned the leased property since the 1980s. *Id*, p. A-40.

On November 1, 1988, Baker Ranch and El Toro executed a lease agreement with a term of ten years and seven months. Appendix D, p. A-40. The lease contained the following provisions:

> [ARTICLE] 9.01. Throughout the term of this Lease, El Toro, at its sole cost and expense, shall promptly comply with all present and future laws, ordinances, orders, rules, regulations and requirements of all federal, state, county and municipal governments, departments, commissions, boards and offices, including but not limited to the conditions set forth in all existing permits . . . . .
>
> [ARTICLE] 10.01 El Toro shall have the right to use the Premises only for

the following:

(a) Subject to the conditions set forth in all applicable government permits, the removal from the Premises of rock, sand, gravel, and fill materials ....

(b) The storage of materials procured from or off the Premises which are used in conjunction with [the permitted mining operations described in the lease].

[ARTICLE] 10.05 As additional consideration for [Baker Ranch] entering into this Lease, El Toro shall conduct all of its operations in a workmanlike manner in accordance with sound engineering and mining principles and practice, though Lessor hereby acknowledges that El Toro does not have an engineer on the Premises at all times, and consistent with the reshaping of the Premises as follows:

(a) The Premises shall be restored to as near as practical with the grade as outlined in El Toro's Reclamation Plan granted by the County of Orange . . .

and the finished grade as set forth in El Toro's Grading Permit . . . or as said Grading Permit is later amended with the written consent of Lessor . . . .

(c) All settlement ponds and debris deposits will be removed from the Premises prior to the termination of the term, except as same are necessary to complete El Toro's operations within the term of the Lease, which remaining ponds and deposits shall be removed no later than four (4) months following the date of termination.

[ARTICLE] 23 SURRENDER – END OF THE TERM
On the expiration or other termination of the term of this Lease . . . . El Toro shall quit and surrender the Premises to Lessor, in good order and condition, as set forth in Section 10.05 hereinabove, free and clear of lettings, subtenancies and occupancies and of all liens and encumbrances other than those, if any, created by Lessor.

Appendix D, pp. A-40-A-42.

El Toro and Baker Ranch executed an amendment to the lease on the same day they executed the lease. The amendment provided Baker Ranch with the right to bifurcate the lease into two separate leases in connection with a division of the property into two separate lots and a sale or transfer of either lot. The amendment further specified that, upon bifurcation of the property into Plots 1 and 2, the lease would continue in effect with the fee owners of either plot. Appendix D, pp. A-42-A-43.

On June 20, 1997, SVCC and El Toro executed a conditional amendment to El Toro's lease with Baker Ranch in anticipation of SVCC's purchase of Plot 1. Appendix D, p. A-42. At the time, SVCC owned property adjoining the Baker Ranch property. *Id.* One of the modifications between SVCC and El Toro extended El Toro's lease term indefinitely, subject to termination by either party upon two years' notice. *Id.* SVCC purchased Plot 1 in 1999. Two years later, in December 2001, SVCC gave El Toro two years' notice of its intent to terminate the lease. *Id.*

On October 18, 2002, more than a year before the lease was scheduled to expire, SVCC gave El Toro a "Thirty (30) Day Notice to Perform or Quit." Appendix D, p. A-43. Although Article 10.01 granted El Toro the right to store materials used in

conjunction with its mining operation on the property and Article 23, which obligated El Toro to surrender the premises in good order and condition, only took effect upon "expiration or other termination of the term of this Lease," the notice alleged that El Toro had violated Articles 9.01 and 23 of the lease "by stockpiling waste material generated in the sand and mining operation." *Id.* SVCC demanded that El Toro remove or dispose of the waste material within thirty days, vacate Plot 1, or face legal action. *Id.*, pp. A-43-A-44. The SVCC Notice to El Toro also provided that if El Toro did not comply with SVCC's demands within the 30 days, that SVCC elected to declare a forfeiture of the Lease.

B. Bankruptcy Court Proceedings

El Toro filed for protection under Chapter 11 of the United States Bankruptcy Code on November 18, 2002. Appendix D, p. A-43. Karen Sue Naylor was appointed Chapter 11 Trustee on October 1, 2003. *Id.*, p. A-43, n. 5. On January 24, 2003, El Toro and SVCC filed a stipulation providing that El Toro would reject the lease effective upon the bankruptcy court's order, which was approved on January 27, 2003. Appendix D, p. A-44. El Toro was allowed to remain in possession of Plot 1 until April 30, 2003, when it vacated the premises.

In 2003, SVCC filed a proof of claim for $23 million based upon El Toro's failure to remove the stockpile pursuant to the covenants of the lease. El Toro filed an objection to the claim alleging that the size of the claim was wildly inflated, bore no relation to actual damages, and was subject to the damages cap set forth in Bankruptcy Code § 502(b)(6). In addition, El Toro filed a complaint against SVCC initiating the adversary proceeding from which this appeal arises. The bankruptcy court consolidated El Toro's objection to SVCC's proof of claim and the adversary proceeding in an order dated October 24, 2003. Appendix D, pp. A-45-A-46.

In its complaint, El Toro alleged, *inter alia*, that SVCC breached the lease agreement and interfered with El Toro's relationship with its subtenants and with its plan to shift its operation to Plot 2. SVCC answered and asserted counterclaims against El Toro for, as relevant to this appeal, breach of the lease and state law claims for waste, nuisance, and trespass."[6] Appendix D, p. A-47.

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[6] In its initial answer and counterclaim, SVCC asserted that El Toro's failure to remove the stockpile constituted a breach of the lease but did not assert the failure to remove the stockpile constituted a tort. Apparently realizing the impact of the damage cap contained in Bankruptcy code § 502(b)(6), SVCC subsequently amended its counterclaim to add tort causes of action based upon the same conduct that constituted breaches of the lease.

All four of SVCC's counterclaims were premised, in whole or in part, on El Toro's stockpiling of mining byproducts on Plot 1. In particular, the trespass claim focused on El Toro's postpetition, post-rejection failure to remove the stockpiled waste. Specific to this claim, SVCC identified its damages as including the cost of removing the stockpiled material and restoring Plot 1 as detailed in a reclamation plan. In its prayer for relief, SVCC also requested that the bankruptcy court issue an injunction requiring El Toro to remove the mining waste and any other property it had left behind on the leased property. Appendix D, pp. A-45-A-46.

On November 3, 2004, El Toro filed a motion for partial summary adjudication in which it asked the bankruptcy court to apply the Bankruptcy Code § 502(b)(6) cap on claims of a lessor for damages to both SVCC's proof of claim and to its counterclaims in the adversary proceeding; to dismiss SVCC's counterclaim for interference with prospective economic advantage; and to dismiss SVCC's request for injunctive relief requiring it to remove the mining waste. Appendix D, p. A-46.

The bankruptcy court granted El Toro's motion in part. Appendix E, p. A-92. In its Order Granting In Part Debtor's Motion for Partial

Summary Adjudication, the court held:

> (1) All of [SVCC's] claims for damage due to the debtor's nonperformance under the lease in this case, including damages for breach of lease covenants, are limited by the "cap" in Section 502(b)(6) of the Bankruptcy Code as damages resulting from "termination" of the subject lease.[7]
>
> (2) [SVCC's] claims for damages arising from tortious or illegal acts (specifically, those for nuisance and waste) are not limited by the "cap" in Section 502(b)(6) of the Bankruptcy Code.

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[7] This belies the Ninth Circuit's statement that "the ruling of the bankruptcy court on [the issue of the breadth of the section 502(b)(6) cap] was entirely favorable to Saddleback." *In re El Toro Materials Company, Inc., supra,* 504 F.3d at 982. SVCC did not appeal the portion of the decision holding that all damages for breach of lease covenants were capped. Nevertheless, the Ninth Circuit's decision seems to hold that only damage of claims for breach the covenant to pay rent are capped. Because the Ninth Circuit decided an issue not posed by the appeal and its decision conflicts with that of other Circuits, review by this Court is necessary and appropriate.

(3) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure with regard to [SVCC's] counterclaim for Trespass.

(4) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure with regard to [SVCC's] claim for injunctive relief.

(5) Debtor's Motion for Partial Summary Adjudication is denied with respect to Debtor's claim that [SVCC] lacks standing to bring suit to enforce the provisions of permits issued to the Debtor by governmental agencies or to maintain a private cause of action under the California Surface Mining Act of 1975.

(6) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure with regard

> to [SVCC's] claim for Interference with Prospective Economic Advantage.

Id., Appendix E, pp. A-92-A-95.

"Although the judgment did not dispose of all the claims raised in the adversary proceeding, the bankruptcy court certified it as a final order pursuant to FRCP 54(b), applicable via [Bankruptcy] Rule 7054." Appendix D, p. A-48.

C. Appeal To The Bankruptcy Appellate Panel of the Ninth Circuit

"After the bankruptcy court denied their respective motions for reconsideration, El Toro and SVCC each timely appealed the judgment. El Toro [sought] review of the bankruptcy court's decision concerning application of the [Bankruptcy Code] § 502(b)(6) cap; SVCC [appealed the] dismissal of its trespass claim." Appendix D, p. A-49.

The Bankruptcy Appellate Panel of the Ninth Circuit reversed the bankruptcy court's decision on both counts. In its decision in favor of El Toro that the § 502(b)(6) cap applied to all of SVCC's causes of action, including tort causes of action, the Bankruptcy Appellate Panel of the Ninth Circuit

stated:

> Here, we need only determine whether a lessor's claim for damages caused by a lessee's acts, which acts also constitute a breach of its lease, should be excluded from the reach of the §502(b)(6) cap, simply because those same acts may constitute a state law tort, or because those acts also violate a state or local regulation or ordinance. When the issue is properly framed, it is apparent that if the cap is not applied, SVCC will succeed in a classic end-run around the will of Congress.

Appendix D, p. A-62.

The fact that SVCC's nuisance and waste claims were "based upon El Toro's failure to remove the mining residue from the leased property, conduct that SVCC in its proof of claim concedes constitutes a violation of the lease," was central to the BAP's conclusion that the § 502(b)(6) cap applied to SVCC's tort claims. Appendix D, p. A-49. According to the BAP, its conclusion was "based upon the language of the Bankruptcy Code, the interpretations previously given this provision by this Panel, and, importantly, is required by the critical undisputed facts of this

case." *Id.*

According to the Bankruptcy Appellate Panel, the language of Bankruptcy Code § 502(b)(6) "is simple enough and is not ambiguous." Appendix D, p. A-52. "The words in the statute do not distinguish between a lessor's claims founded upon contract, tort, statute or some other legal basis." *Id.* "If the lessor holds a claim for 'damages,' the claim is capped." *Id.*

The Bankruptcy Appellate Panel noted that its conclusion was consistent with the Panel's decision in *Kuske v. McSheridan (In re McSheridan)*, 184 B.R. 91 (9th Cir. BAP 1995), in which it concluded that the cap applied to claims for repair and renovation of leased premises and not merely to claims for future rent.

Finally, the Panel found reversal of the bankruptcy court's order compelled by the undisputed facts, including the following lease terms which it characterized as "critical" to the appeal:

> - El Toro was allowed by the lease to mine and remove rock, sand, gravel and fill materials from the land. This provision contemplated that El Toro would wash sand from excavated materials, a process that created the

"goo," "residue" or "debris" involved in this case.

- Incident to its operations, El Toro was authorized by the lease to store materials it mined from the land on the leased premises. Fairly read, this provision authorizes El Toro to stockpile the residue.

- El Toro committed to remove "'debris deposits" from the leased premises "no later than four (4) months following the date of termination [of the lease]." This provision reflects the parties' understanding that, upon termination of the lease, there may be stockpiles of residue remaining on the leased premises.

Appendix D, pp. A-60-A-61.

According to the BAP, "the undisputed facts in this appeal show the same conduct that SVCC alleges constitutes nuisance and waste in this case also constitutes a breach of the lease." Appendix D, p. A-51.

Although it expressed no opinion on the

merits of SVCC's trespass claim, the BAP held that the bankruptcy court erred in dismissing such claim. Appendix D, p. A-74. BAP concluded that such claim would also be subject to the § 502(b)(6) cap. *Id.*, p. A-74.

D. Appeal To The Ninth Circuit Court Of Appeals

SVCC appealed to the Ninth Circuit. On October 1, 2007, the Court of Appeals reversed BAP's decision on the scope of the Bankruptcy Code § 502(b)(6) cap. *In re El Toro Materials, Inc., supra*, 504 F.3d at 982. In the process, the court also overruled *In re McSheridan, supra*, 184 B.R. 91. *Id.* The Court of Appeals denied El Toro's motion for rehearing or rehearing en banc on November 6, 2007. Appendix B, p. A-21.

The Court of Appeals based its decision in part on its perception that it was logical to limit application of the cap to claims for future rent and its fear that extending the cap to collateral damage would allow tenants to damage property without fear of liability beyond the cap. *In re El Toro Materials, Inc., supra*, 504 F.3d at 981. It found that the statutory language of Bankruptcy Code § 502(b)(6) supported its interpretation. *Id.* at 980.

According to the Court of Appeals, "it makes sense to cap damages for lost rental income based on the amount of expected rent: Landlords may have the ability to mitigate their damages by re-leasing or selling the premises, but will suffer injury in proportion to the value of their lost rent in the meantime." *In re El Toro Materials, Inc., supra*, 504 F.3d at 980. "In contrast, collateral damages are likely to bear only a weak correlation to the amount of rent: A tenant may cause a lot of damage to premises leased cheaply, or cause little damage to premises underlying an expensive leasehold." *Id.*

REASONS FOR GRANTING THE PETITION

A. The Ninth Circuit's Conclusion That SVCC's Damages Did Not Arise Upon Rejection Of The Lease Conflicts With It's Own Decision In *TreeSource*.

As the Ninth Circuit Court of Appeals observed, "[t]he cap applies to damages 'resulting from' the rejection of the lease. 11 U.S.C. § 502(b)(6)." *In re El Toro Materials, Inc., supra*, 504 F.3d at 980. The Court of Appeals held that SVCC's damage claims did not result from rejection of the lease, however, but rather from "the pile of dirt allegedly left on the property." *Id.* This statement is not only a non sequitur but is also inconsistent with

the Ninth Circuit's decision in the case of *In re TreeSource Indus., Inc., supra,* 363 F.3d at 995.

In *TreeSource*, Midway, an affiliate of the debtor, entered into a prepetition lease with K-4, Inc. ("K-4"), as the lessor. The lease provided that "Lessee will, at Lessee's sole cost and expense, keep and maintain the said premises and will return the same to the Lessor in the same condition as the same was in at the commencement of this Lease, reasonable wear and tear excepted." [8] *In re TreesSource Indus., Inc., supra*, 363 F.3d at 996.

The lease also provided:

> Upon termination or expiration of the Lease, Lessee shall remove all fixtures and equipment on the premises and shall, with respect to improvements made after March 1, 1997, remove such improvements, footings, floors, foundations, and shall regrade the premises to natural contours after removing all debris and other incidental material brought onto the premises by Lessee.[9]

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[8] In its lease with SVCC, El Toro covenanted to "quit and surrender the Premises to Lessor, in good order and condition . . . ." Appendix D, p. A-42.

[9] El Toro covenanted that the "Premises shall be restored to as near as practical with the grade as outlined in El Toro's Reclamation Plan" and agreed to remove "debris deposits" from

In re TreesSource Indus., Inc., supra, 363 F.3d at 996.

The debtor and its affiliates, including Midway, filed bankruptcy on September 27, 1999. In September 2001, Midway removed the building it constructed on the leased premises but did not remove the concrete slab under the building or restore the premises as required by the lease. On October 19, 2001, Midway rejected the lease. K-4 filed a motion requesting allowance and payment of an administrative expense claim of $155,814.65 for Midway's failure to remove the concrete slab and restore the premises and $72,275.01 for Midway's failure to repair and maintain the premises.

The bankruptcy court ruled that K-4 was not entitled to an administrative expense claim because the removal and maintenance obligations arose "only upon termination or expiration of the lease, which occurred upon rejection." *In re TreeSource Indus., Inc., supra,* 363 F.3d at 997. The district court affirmed. K-4 filed a timely notice of appeal to the Ninth Circuit.

Although the Ninth Circuit Court of Appeals

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the leased premises "no later than four (4) months following the date of termination [of the lease.]." Appendix D, pp. A-42-A-43. Thus, it was only upon lease rejection that SVCC could claim to be harmed.

could have said, as it did in El Toro's case, that the lessor's damage claims did not result from rejection of the lease but rather from the concrete slab and debris left on the property, it affirmed the district court. As the court recognized:

> Under the terms of the lease, the Removal Obligation arose "upon termination or expiration of The Lease." The termination or expiration of the lease occurred when Midway rejected the lease..... Therefore, the resulting damage action for Midway's failure to comply with the Removal Obligation is treated as a pre-petition general unsecured claim for rejection damages ....

In re TreeSource Indus., Inc., *supra*, 363 F.3d at 998.

Although Midway argued that the maintenance obligation arose in part during the post-petition, pre-rejection period, the Court of Appeals also held that the obligation to keep and maintain the property in proper condition was breached only when Midway rejected the lease.

As the Court of Appeals noted:

> Although the lease stated that Midway had to keep and maintain the premises, the only relevant time that the premises had to be in proper condition was when Midway returned the land – when the lease ended. When Midway rejected the lease, it simultaneously breached this obligation.

In re TreeSource Indus., Inc., supra, 363 F.3d at 999.

The Ninth Circuit's decision in the present case cannot be reconciled with its decision in *TreeSource.* This is clear when the "simple test"[10] the court formulated to determine whether damages result from the rejection of a lease in El Toro is applied to the facts in *TreeSource.*

In *TreeSource*, the harm consisted of the

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[10] "Saddleback's claims for waste, nuisance and trespass do not result from the rejection of the lease – they result from the pile of dirt allegedly left on the property. Rejection of the lease may or may not have triggered Saddleback's ability to sue for the alleged damages. But the harm to Saddleback's property existed whether or not the lease was rejected. A simple test reveals whether the damages result from the rejection of the lease: Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it?" *In re El Toro materials Co., Inc., supra*, 504 F.3d at 980-981.

debtor's failure to remove a concrete building slab, repair and maintain the property, and restore the property to its pre-lease condition. As the court said in El Toro, rejection of the lease may or may have triggered K-4's ability to sue for the alleged damages but that harm could be said to exist "whether or not the lease was rejected." The concrete building slab "was not put there by the rejection of the lease – it was put there by the actions and inactions" of Midway, the debtor. Rather than concluding that K-4's damage claim did not result from the rejection of the lease but rather from the slab of concrete left on the property, however, the Ninth Circuit held that the removal and restoration obligations "arose upon termination or expiration of the Lease" and constituted claims for rejection damages. *In re TreeSource Indus., Inc., supra*, 363 F.3d at 998.

Here, as in *TreeSource*, El Toro's obligation to remove the debris and restore the premises arose upon termination or expiration of the lease. As BAP noted, the lease allowed El Toro to conduct the mining operations that created the debris, authorized El Toro to store or stockpile the debris, and allowed El Toro up to four months "following the date of termination" of the lease to remove the debris if necessary to complete El Toro's operations. Appendix D, p. A-63.

Given these lease terms, the Ninth Circuit erred as a matter of law when it concluded that "the harm to Saddleback's property existed whether or not the lease was rejected." Generation and storage of mining waste on the property did not produce a debt or claim or constitute a tort. The obligation to clean up and restore the premises did not arise until the lease was rejected.

In stating that "the harm to [SVCC's] property existed whether or not the lease was rejected", the Ninth Circuit incorrectly reasoned that "[SVCC] would still have the same claim it brings today had El Toro accepted the lease and committed to finish its term..." In fact, SVCC would have had no claim if El Toro had assumed the lease. As the Bankruptcy Court stated in *In re Mr. Gatti's, Inc.*, 162 B.R.1004, 1011 (Bankr. W.D. Tex. 1994), "(o)nce assumed, the landlord is no longer faced with a possible breach and does not file a proof of claim against the estate for pre-petition damages." Thus, the "simple test" proves that the alleged damages of SVCC are rejection damages.

"Common sense" tells us "that a lessor's damages are not 'caused' by technical termination of a lease ...." "*In re El Toro Materials Co., Inc., supra*, 504 F.3d at 981." *In re Mr. Gatti's, Inc., supra*, 162 B.R. at 1012 (Bankr. W.D. Tex. 1994). "Damages are

'caused' by a tenant's actual non-performance of its obligations," which occurs when a debtor rejects a lease, thereby "rejecting its future performance of all of the covenants contained within the lease." *Id.* Until the lease was rejected and El Toro repudiated its removal and restoration obligations, however, SVCC could not file a claim or claim to be harmed by El Toro's generation and storage of waste material, which SVCC knew about before it purchased the property [11] and expressly assented to when it purchased the property subject to the lease and extended the lease term indefinitely subject to termination upon two-years' notice. Appendix D, p. A-64.

It was only upon rejection of the lease that El Toro breached the lease covenants obligating it to remove the settlement ponds and debris deposits and to restore the property to the grade outlined in El Toro's reclamation plan. "The undisputed facts," as BAP observed, "show the same conduct that SVCC alleges constitutes nuisance and waste in this case also constitutes a breach of the lease." Appendix D, p. A-51.

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[11] As BAP stated, it is "disconcerting" that SVCC, which purchased adjoining property and the lessor's ownership interest more than ten years after El Toro began its business on the leased property "could recover, years later, under state tort law for El Toro's continuing activities." Appendix D, p. A-64 n.12.

In holding that SVCC's claim for damages against El Toro for failing to remove the stockpile and to regrade the premises did not arise upon the termination or expiration of the lease and did not give rise to a claim for rejection damages, the Ninth Circuit created a conflict with its own decision in *TreeSource*.

Courts that hold, as the Ninth Circuit did in *TreeSource*, that claims against a debtor for the failure to fulfill repair, maintenance, removal, or restoration obligations in a lease arise upon termination or expiration of the lease and gave rise to a claims for rejection damages are unanimous in holding that Bankruptcy Code § 502(b)(6) caps these claims. See, *e.g.*, *In re Foamex Int'l, Inc.*, 368 B.R. 383, 394 (Bankr. D. Del. 2007); *In re McSheridan*, *supra*, 184 B.R. at 100-101 (*overruled*, *In re El Toro Materials, Inc.*, *supra*, 504 F.3d 978; 2007); *In re Mr. Gatti's, Inc.*, *supra*, 162 B.R. at 1013-1014. See also *In re Clements*, 185 B.R. 895, 902-903 (Bankr. M.D. Fla. 1995) (holding that the cap applies to all damages, whether for non-payment of rent, taxes, costs, attorney's fees or other financial covenants without discussing repair and restoration obligations); *In re Storage Technology Corp.*, 77 B.R. 824, 825 (Bankr.D.Colo. 1986) (same). Courts that hold, as the Ninth Circuit did in *El Toro*, that damage claims for the failure to fulfill repair,

maintenance, removal, or restoration obligations are unrelated or collateral to termination or expiration of the lease and do not give rise to rejection damages uniformly hold that the cap does not apply. See, *e.g.*, *In re Best Products Co., Inc.*, 229 B.R. 673, 679 (Bankr. E.D. Va. 1998); *In re Bob's Sea Ray Boats, Inc.*, 143 B.R. 229, 231 (Bankr. D. N.D. 1992); *In re Atlantic Container Corp.*, 133 B.R. 980, 987-988 (Bankr. N.D. Ill. 1991).

The Ninth Circuit Court of Appeals claims that its ruling in *El Toro Materials, Inc.* is "consistent" with *TreeSource* because "[p]rioritization of the claim is a separate issue from determining the amount of the claim that will be permitted." *"In re El Toro Materials Co., Inc., supra*, 504 F.3d at 981, n.5." While it is true that the Ninth Circuit was not faced with the issue of the § 502(b)(6) cap in *TreeSource*, it was squarely confronted with the issue of whether a lessor's damages for a tenant's failure to repair and maintain property, remove debris, and regrade property to its natural contours arises upon termination or expiration of the lease and gives rise to a claim for rejection damages. It answered that question in the affirmative. *In re TreeSource Indus., Inc., supra*, 363 F.3d at 998-999. This ruling should have been dispositive of the El Toro appeal because "[a] lessor's claim for damages for termination of an

unexpired lease is subject to [the] statutory cap. Section 502(b)(6)." *In re Atlantic Container Corp.*, 133 B.R. 980, 985.

B. The Ninth Circuit's Holding That Bankruptcy Code § 502(b)(6) Caps Only Claims For Future Rent Conflicts With Decisions By The Third And Sixth Circuits Court Decisions, The Text Of The Statute, And Its Legislative History.

The Ninth Circuit's holding that Bankruptcy Code § 502(b)(6) does not apply to "collateral damages," defined as "damages other than those based on loss of future rental income"[12] conflicts with decisions of the Third and Sixth Circuit Courts of Appeals and is inconsistent with the unambiguous text of the statute, its legislative history, and pre-Code practice.

In *Capitol Industries, Inc. v. Regal Cinemas, Inc. (In re Regal Cinemas, Inc.)*, 393 F.3d 647 (6th Cir. 2004), Capitol Industries, the lease guarantor, argued that the Bankruptcy Code § 502(b)(6) cap

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[12] "According to the Ninth Circuit, "the structure of the cap—measured as fraction of the remaining term—suggests that damages other than those based upon a loss future rental income are not subject to the cap." *In re El Toro Materials, Inc., supra*, 504 F.3d at 980.

applies solely to claims based upon loss of future rental income attributable to the breach of the lease. Capitol noted that some of its claims "did not relate to rent under the lease—such as legal fees, costs for maintaining the premises . . . and real estate taxes," and argued these claims "should not have been barred by the cap on such damages . . . ." *Id.*, 393 F.3d at 649.

The Sixth Circuit Court of Appeals rejected that argument. *In re Regal Cinemas, Inc.*, *supra*, 393 F.3d at 649. In affirming the district court's decision, the Court of Appeals necessarily held that the cap applied to damages other than just those based on loss of future rental or, in other words, to claims for what the Ninth Circuit characterizes as "collateral damages."

The Ninth Circuit's decision also conflicts with *First Bank National Association v. FDIC*, 79 F.3d 362 (3d Cir. 1996). In *First Bank*, the Third Circuit Court of Appeals, interpreting a statute analogous to Bankruptcy Code § 502(b)(6), held that the cap on damages arising when a receiver disaffirms a lease applies to all damages, including damages resulting from the failure to perform structural repairs and modify the building to comply with federal laws and regulations, not merely to damages for future rent. *Id. at* 367.

First Bank turned upon the interpretation of 12 U.S.C. § 1821(e)(4), a provision of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA") that caps the damages recoverable from the FDIC when it disaffirms a lease. According to the Third Circuit, "[t]his provision, like much of FIRREA, was modeled after the Bankruptcy Code, in this instance, 11 U.S.C. § 502(b)(6), the provision dealing with a trustee's obligations if it terminates a lease." *First Bank National Association v. FDIC*, supra, 79 F.3d at 366.

Section 1821(e)(1) of FIRREA, which parallels the provisions of Bankruptcy Code § 365(a), grants a conservator or receiver for any insured depository institution the right to disaffirm or repudiate any contract or lease. Section 1821(e)(4) provides in pertinent part that a conservator or receiver who disaffirms or repudiates a lease shall not be liable for any "damages" for the disaffirmance or repudiation of the lease other than "contractual rent" accruing before the later of the date the notice of disaffirmance or repudiation is mailed or becomes effective. 12 U.S.C. § 1821(e)(4).[13]

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[13] Cf. Bankruptcy Code § 502(b)(6), which provides for the disallowance of a claim of a lessor for "damages" resulting from the termination of a lease to the extent the claim exceeds the rent reserved by the lease for the greater of one year of 15 percent, not to exceed three years, of the remaining lease term.

The FDIC was acting as the receiver for Meritor Savings Bank ("Meritor"). Meritor had entered into a sublease with First Bank National Association ("First Bank"). Meritor's lease required it to comply with all laws, ordinance and regulations, and other governmental rules. *First Bank*, *supra*, 79 F.3d at 365. Meritor also agreed to maintain all parts of the premises in good repair and to make all repairs necessary to keep the premises in good condition.[14] *Id.*

The FDIC disaffirmed the sublease. First Bank filed a claim with the FDIC seeking, in addition to unpaid rent, $285,000 for modification of the building to comply with the American with Disabilities Act ("ADA") and $980,000 for rehabilitation of the north facade of the building. The district court disallowed the claims for modifying the building to comply with the ADA and renovating the facade.

On appeal to the Court of Appeals for the Third Circuit, First Bank argued that 12 U.S.C. §

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[14] Cf. El Toro's lease, which required it to comply with "all present and future laws, ordinances, orders, rules, regulations and requirements of all federal, state, county and municipal governments ... including but not limited to the conditions set forth in all existing permits ..." and to "quit and surrender the Premises to Lessor, in good order and condition ...." Appendix C, pp. A-23-A-35.

1821(e)(4) "limits claims only to the extent of 'any damages . . . for the disaffirmance or repudiation of such lease.'" *First Bank*, *supra*, 79 F.3d at 367. Since the damages for the costs to repair the facade and to comply with the ADA did not result from disaffirmance of the lease, First Bank argued, § 1821(e)(4) did not cap the claims. *Id.*

This is the same argument the Ninth Circuit Court of Appeals considered in a bankruptcy context in *El Toro*.[15] Unlike the Ninth Circuit, however, the Third Circuit rejected the argument and found that the cap applied to all damages, not merely to claims for rent.

The Third Circuit relied upon *McSheridan*, which the Ninth Circuit overruled in *El Toro*, to hold that damage claims for the breach of covenants, including covenants to repair, renovate, and remodel, are termination damages. *First Bank*, *supra*, 79 F.3d at 367. In *McSheridan*, as the Third Circuit noted, the BAP held that the "analogous portion of

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[15] In *In re El Toro Materials, Inc.*, *supra*, 504 F.3d 978, the Ninth Circuit stated that "[t]he cap applies to damages 'resulting from' the rejection of the lease. 11 U.S.C. § 502(b)(6)." Finding that SVCC's tort claims for the failure to remove mining waste and restore the property to its pre-lease condition "do not result from the rejection of the lease," *id.*, the Ninth Circuit held that the cap did not apply to SVCC's damages.

[the] bankruptcy code encompasses all claims for breach of lease; specifically rejecting [the] argument that appellant's claims for prepetition breach of covenants [were] not 'termination' damages" and therefore not covered by the cap. *Id.*

Significantly, "the Third Circuit's decision in *First Bank* adopted the reasoning of *McSheridan* and did so applying bankruptcy law ...." *In re Foamex Int'l, Inc., supra*, 368 B.R. at 393. The Bankruptcy Court for the District of Delaware read *First Bank* as "the Third Circuit's implicit, if not explicit, approval of the *McSheridan* rationale and holding" in *Foamex*. *Id.*, p. 393, n. 12. The Delaware Bankruptcy Court recently relied upon *First Bank* in adopting *McSheridan's* holding that rejection of a lease constitutes a breach of the lease and all covenants and allows a lessor to file a claim for all damages, which then triggers the § 502(b)(6) cap. *Id.*, p. 393.

Absent some compelling reason to read analogous phrases in two statutes differently, they should be interpreted consistently. *United States v. Germaine (In re Germaine)*, 152 B.R. 619, 626 (BAP 9th Cir. 1993). The Ninth Circuit mentioned no such compelling reason in *El Toro*.

In overruling *McSheridan*, the Ninth Circuit simply reasoned that it "[made] sense to cap damages for lost rental income" but not to cap "collateral damages" that bear only a weak correlation to the amount of rent. Whether or not this argument is appealing in light of the policy reasons for the cap, it is not the law. The Court's holding that "damages other than those based on a loss of future rental income are not subject to the cap" is contrary to the text of the statute and inconsistent with its legislative history and pre-Code practice.

Congress capped "damages resulting from the termination of a lease of real property" rather than simply capping a landlord's claims for future rent. 11 U.S.C. § 502(b)(6). The cap was to be calculated on the basis of the "the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease .... 11 U.S.C. § 502(b)(6)(A).

The text and structure of § 502(b)(6) demonstrate that Congress knew how to draw a distinction between "damages" and "rent." While the cap is calculated by applying a formula to the rent reserved for the remaining term of the lease, the cap applies to "damages" generally rather than being

limited to damage claims for future rent. See, e.g., *In re Storage Technology*, 77 Bankr. 824, 825 (Bankr. D. Colo. 1986) ("This language [referring to § 502(b)(6)] does not qualify or in any way limit the type of damages involved").

As the Bankruptcy Appellate Panel observed:

> The language is simple enough and is not ambiguous. The Code applies the cap to a lessor's claim for "damage." The words in the statute [§502(b)(6)] do not distinguish between a lessor's claims founded upon contract, tort, statute or some other legal basis. If the lessor holds a claim for 'damages,' the claim is capped. All kinds of damages claims are logically included within the reach of the cap. As a result, under a plain reading of the statute, there is no reason to infer a limitation on the type of damages a lessor may recover under the statute.

Appendix D, p. A-52.

As this Court has repeatedly emphasized, "courts must presume that a legislature says in a statute what it means and means in a statute what

it says . . . . When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete." *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 253-54, 112 S. Ct. 1146, 117 L. Ed. 2d 391, (1992) (internal citations omitted). In concluding that "damages" should be interpreted to mean something less than all damages, the Ninth Circuit ignored the unambiguous words of the statute.

In an analogous context, when asked to interpret the word "creditors" in the Bankruptcy Act [11 U.S.C. § 95(e)] to exclude creditors holding insignificant claims, the Ninth Circuit stated:

> Since Congress made no distinction between large and small claims, we cannot arrogate unto ourselves the power to do so and thereby engraft an additional exception to the Act. Hornblower's argument properly should be addressed to the Congress.

In re Okamoto, 491 F.2d 496, 498 (9th Cir. 1974).

Since Congress made no distinction between damages for future rent and "collateral" damages for the breach of a covenant to restore property to its

pre-lease condition, whether the landlord chooses to base its claim upon contract or tort, the Ninth Circuit cannot arrogate unto itself the power to do so. Legislation is the function of Congress, not the courts.

Interpreting the word "damages" to encompass "collateral damages" is consistent with the legislative history and pre-Code practice. As the Bankruptcy Appellate Panel stated:

> The legislative history states that the provision "limits the damages allowable to a landlord of the debtor," and that the purpose of the statute is "to compensate the landlord for his loss while not permitting a claim so large (based on a long-term lease) as to prevent other general unsecured creditors from recovering a dividend of the estate." S. Rep. No. 95-989, reprinted in 1978 U.S.C.C.A.N. 5787, 5849; H.R. Rep. No. 95-595, reprinted in 1978 U.S.C.C.A.N. 5963, 6309. The history also states that a landlord's "allowed claim is for his **total damages**, as limited by this paragraph," . . . .

Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.), 306 B.R. 295, 298 (BAP 9th Cir. 2004) (emphasis added).

Although the Ninth Circuit regarded it as illogical and unfair to interpret "damages" to include collateral damages, it recognized that claims by landlords against bankrupt tenants "have always been treated differently than other unsecured claims." *In re El Toro Materials Co., Inc.* 504 F.3d at 979. As the Ninth Circuit conceded:

> Prior to 1934, landlords could not recover at all for the loss of rental income they suffered when a bankrupt tenant rejected a long-term lease agreement; future lease payments were considered contingent and thus not provable debts in bankruptcy. See *Manhattan Props., Inc. v. Irving Trust Co.*, 291 U.S. 320, 332-36, 338 (1934).

Id.

In 1934, Congress amended the Bankruptcy Act to make landlord claims for lease rejection "damages" provable but capped these claims by providing that damages "shall in no event be allowed in an amount exceeding the rent reserved by the

lease, without acceleration, for the year next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after bankruptcy ...." *Oldden v. Tonto Realty Corp.*, 143 F.2d 916, 917 (2d Cir. 1944) [citing Bankruptcy Act § 63a(9)]. Then, as now, the cap applied to all damages.

As the Bankruptcy Court for the Western District of Texas observed:

> There is little dispute that prior to the adoption of the Bankruptcy Code, a landlord's claim for ***any*** damages resulting from the rejection of the lease by the Debtor, including ***any*** and ***all*** damages for breach of any covenants within the lease, were to be computed and then allowed within the limits of § 63a(9).

In re Mr. Gatti's, Inc., supra, 162 B.R. at 1008 (emphasis added); See also *In re Storage Technology, supra*, 77 B.R. at 825 ("The damage cap applies to *all* damages, which are then arbitrarily capped and measured by rent reserved. Such a cap has been in the bankruptcy laws for many years.")

This Court is "reluctant to accept arguments

that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992) (citations omitted). The Ninth Circuit expressly conceded that Congress expressed no intention of departing from pre-Code practice in the legislative history of Bankruptcy Code § 502(b)(6).[16] Thus, the Ninth Circuit erred in restricting the scope of "damages" subject to the cap to rent claims.

The Ninth Circuit's concern that extending the cap to cover any collateral damage to the premises would allow a post-petition but pre-rejection tenant to damage the premises, or even to burn down the property "in a fit of pique," without fear of liability beyond the cap is misplaced for two reasons.

First, as BAP expressly noted in discussing the "undisputed material facts":

> This is not a case, as SVCC's

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[16] As the Ninth Circuit noted, quoting the Senate Report the accompanied the Bankruptcy Reform Act of 1978, "Section 502(b)(6) was intended to carry forward existing law . . . ." *In re El Toro Materials, Inc., supra*, 504 F.3d 980.

> approach suggests, where one party commits an intentional tort (or even a crime) against another while those parties, as a matter of coincidence, occupy the status of tenant and landlord. Those are not our facts.

Appendix D, p. A-66.

Second, a claim for damaging premises post-petition, as opposed to a claim for failing to restore or repair premises, does not constitute "damages resulting from the termination of a lease of real property." As such, the cap would not apply.

Moreover, the Circuit's strained interpretation of the statute in an effort to remedy what it perceives as a wrong invades the province of Congress. As the Eleventh Circuit Court of Appeals recently observed:

> Our function is to apply statutes, to carry out the expression of the legislative will that is embodied in them, not to "improve" statutes by altering them..... If there are problems with the way a statute operates, Congress can alter the statute to eliminate those problems; we cannot.

Bracewell v. Kelley (In re Bracewell), 454 F.3d 1234, 1246 (11th Cir. 2006) [quoting *Wright v. Sec'y for Dep't of Corr.*, 278 F.3d 1245, 1255 (11th Cir. 2002)]. *See also Lamie v. United States Tr.*, 540 U.S. 526, 542 (2004).

C. The Court of Appeals Has Decided An Important Question of Federal Law That Has Not Been, But Should Be, Settled By This Court.

Although the Ninth Circuit seems to be saying that no damages other than damages based on a loss of future rental income are covered by the cap, *In re El Toro Materials Co., Inc., supra,* 504 F.3d at 980, it is also possible to read the decision as holding only that tort claims are not covered by the cap.

If so, the Court has created an exception to the Bankruptcy Code § 502(b)(6) cap on damages that will quickly swallow the rule. To the extent that the cap does not apply to torts and state law allows landlords to recover on theories of waste, nuisance, or trespass for acts that also violate a lease, Bankruptcy Code § 502(b)(6) will be eviscerated.

In exempting tort claims from the cap, the Ninth Circuit has decided an important question of federal law that has not been, but should be, settled

by this Court if the cap on damages in Bankruptcy Code § 502(b)(6) is not to be repealed by judicial fiat.

CONCLUSION

For the reasons stated, the Court should grant the petition.

Respectfully submitted,

RONALD K. VAN WERT
A Professional Corporation

By: _____
Ronald Van Wert*
Special Counsel for
El Toro Materials
Company, Inc.,
Debtor/Petitioner

MALCOLM ♦ CISNEROS
A Law Corporation

By: _____
Arturo M. Cisneros*
Donald W. Robinson
Counsel for Karen
S. Naylor,
Trustee/Petitioner

**Counsel of Record* *Attorneys for Petitioners*

Bankruptcy Code § 365 provides:

> § 365. Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title [11 USCS §§ 765 and 766] and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee--

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in

accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;

(C) the appointment of or taking possession by a trustee in a case under this title or a

custodian before such commencement; or

(D) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

(3) For the purposes of paragraph (1) of this subsection and paragraph (2) (B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance--

(A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a

radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if--

(1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or

the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor; or

(3) such lease is of nonresidential real property and has been terminated under applicable non bankruptcy law prior to the order for relief.

(d) (1) In a case under chapter 7 of this title [11 USCS §§ 701 et seq.), if the trustee does not assume or reject an executory contract or unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, 12, or 13 of this title [11 USCS §§ 901 et seq., 1101 et seq., 1201 et seq., or 1301 et seq.), the trustee may assume or reject an executory contract or unexpired

lease of residential real property or of personal property of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(3) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2) [11 USCS § 365(b)(2)] [subsec. (b) (2) of this section], arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title [11 USCS § 503(b)(1). The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f.) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

(4)(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately

surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i) the date that is 120 days after the date of the order for relief, or

(ii) the date of the entry of an order confirming a plan.

(B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

(5) The trustee shall timely perform all of the obligations of the debtor, except those specified in section 365(b)(2) [11 USCS § 365(b)(2)], first arising from or after 60 days after the order for relief in a case under chapter 11 of this title [11 USCS §§ 1101 et seq.] under an unexpired lease of personal property (other than personal property leased to an individual primarily for personal, family, or household purposes), until such lease is assumed or

rejected notwithstanding section 503(b)(1) of this title [11 USCS § 503(b)(1)], unless the court, after notice and a hearing and based on the equities of the case, orders otherwise with respect to the obligations or timely performance thereof. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f). Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.

(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;
or

(C) the appointment of or taking possession by a trustee in a case under this title or a

custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if—

(A) (i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(f) (1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease,

the trustee may assign such contract or lease under paragraph (2) of this subsection.

(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.

(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory

contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title [11 USCS §§ 901 et seq., 1101 et seq., 1201 et seq., or 1301 et seq.], immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title [11 USCS §§ 901 et seq., 1101 et seq., 1201 et seq., or 1301 et seq.]—

(A) if before such rejection the case has not been converted under section 1112, 1208, or 1307 of this title[11 USCS § 1112, 1208, or 1307], at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title[11 USCS § 1112, 1208, or 1307]—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion.

11 U.S.C. § 365.

Bankruptcy Code § 502 provides:

§ 502. Allowance of claims or interests

(a) A claim or interest, proof of which is filed under section 501 of this title [11 USCS § 501], is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title [11 USCS §§ 701 et seq.], objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that ··

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under section 523(a)(5) of this title [11 USCS § 523(a)(5)];

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds ··

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease,
following the earlier of—

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds--

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of—

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates;

(8) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor; or

(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title

[11 USCS § 726(a)] or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide, and except that in a case under chapter 13 [11 USCS §§ 1301 et seq.], a claim of a governmental unit for a tax with respect to a return filed under section 1308 [11 USCS §1308] shall be timely if the claim is filed on or before the date that is 60 days after the date on which such return was filed as required.

(c) There shall be estimated for purpose of allowance under this section—

(1) any contingent or unliquidated claim, the fixing or liquidation of which, as the case may be, would unduly delay the administration of the case; or

(2) any right to payment arising from a right to an equitable remedy for breach of performance.

(d) Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title [11 USCS § 542, 543, 550, or 553] or that is a transferee of a transfer avoidable under section 522(d), 522(h), 544,

545, 547, 548, 549, or 724(a) of this title [11 USCS § 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a)], unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title [11 USCS § 522(i), 542, 543, 550, or 553].

(e) (1) Notwithstanding subsections (a), (b) and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on
or has secured the claim of a creditor, to the extent that—

(A) such creditor's claim against the estate is disallowed;

(B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or

(C) such entity asserts a right of subrogation to the rights of such creditor under section 509 of this title[11 USCS § 509].

(2) A claim for reimbursement or

contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.

(f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(g) (1) A claim arising from the rejection, under section 365 of this title [11 USCS § 365] or under a plan under chapter 9, 11, 12, or 13 of this title [11 USCS §§ 901 et seq., 1101 et seq., 1201 et seq., or 1301 et seq.], of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date

of the filing of the petition.

(2) A claim for damages calculated in accordance with section 562 [11 USCS § 562] shall be allowed under subsection (a), (b), or (c), or disallowed under subsection (d) or (e), as if such claim had arisen before the date of the filing of the petition.

(h) A claim arising from the recovery of property under section 522, 550, or 553 of this title [11 USCS § 522, 550, or 553] shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(8) of this title [11 USCS § 507(a)(8)] shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(j) A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim

may be allowed or disallowed according to the equities of the case. Reconsideration of a claim under this subsection does not affect the validity of any payment or transfer from the estate made to a holder of an allowed claim on account of such allowed claim that is not reconsidered, but if a reconsidered claim is allowed and is of the same class as such holder's claim, such holder may not receive any additional payment or transfer from the estate on account of such holder's allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder. This subsection does not alter or modify the trustee's right to recover from a creditor any excess payment or transfer made to such creditor.

(k) (1) The court, on the motion of the debtor and after a hearing, may reduce a claim filed under this section based in whole on an unsecured consumer debt by not more than 20 percent of the claim, if--

(A) the claim was filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment schedule proposed on behalf of the debtor by an approved nonprofit budget and credit counseling agency described in section 111 [11 USCS §111];

(B) the offer of the debtor under subparagraph (A)—

(i) was made at least 60 days before the date of the filing of the petition; and

(ii) provided for payment of at least 60 percent of the amount of the debt over a period not to exceed the repayment period of the loan, or a reasonable extension thereof, and

(C) no part of the debt under the alternative repayment schedule is nondischargeable.

(2) The debtor shall have the burden of proving, by clear and convincing evidence, that—

(A) the creditor unreasonably refused to consider the debtor's proposal; and

(B) the proposed alternative repayment schedule was made prior to expiration of the 60-day period specified in paragraph (1)(B)(i) .

UNITED STATES COURT OF APPEALS F'ILED

FOR THE NINTH CIRCUIT

NOV 0 6 2007
CATHY A. CATTERSON
CLERK U.S. COURT OF APPEALS

No. 05-56164
BAP Nos. CC-04-01287-PaBK
BAP Nos. CC-04-01300-PaBK

ORDER

In re: EL TORO MATERIALS COMPANY, INC.,
Debtor,

SADDLEBACK VALLEY COMMUNITY CHURCH,
Appellant,

v.

EL TORO MATERIALS COMPANY, INC.,
Appellee.

Before: FRIEDMAN *, KOZINSKI and GOULD,
Circuit Judges.

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* The Honorable Daniel M. Friedman, Senior United States Circuit Judge for the Federal Circuit, sitting by designation

The petition for rehearing and rehearing, en banc is denied. See Fed. R. App. P. 35; Fed. R. App. P. 40

2007 U.S. App. LEXIS 22991, *; Bankr. L. Rep. (CCH) P81,021; 48 Bankr. Ct. Dec. 255

In re: ELTORO MATERIALS COMPANY, INC., Debtor, SADDLEBACK VALLEY COMMUNITY CHURCH, Appellant, v. EL TORO MATERIALS COMPANY, INC., Appellee.

No. 05-56164

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

2007 U.S. App. LEXIS 22991; *Bankr. L. Rep. (CCH) P81,021;* 48 *Bankr. Ct. Dec. 255*

June 7, 2007, Argued and Submitted, Pasadena, California
October 1, 2007, Filed

PRIOR HISTORY: [*1]

Appeal from the Ninth Circuit Bankruptcy Appellate Panel, BAP No. CC-04-01287-PaBK, BAP No. CC-04-01300-PaBK, Klein, Brandt and Pappas, Bankruptcy Judges, Presiding.

DISPOSITION: REVERSED and REMANDED.

CASE SUMMARY:

PROCEDURAL POSTURE: Appellant creditor sought review of the United States Court of Appeals for the Ninth Circuit Bankruptcy Appellate Panel's (BAP) decision that reversed the bankruptcy court's decision that found the creditor's recovery would not be limited by the 11 *U.S.C.S.* § *502(b)(6)* cap on damages.

OVERVIEW: Appellee debtor sought to use the provision on the cap on damages that resulted from the termination of a lease of real property to limit its liability for allegedly leaving one million tons of its wet clay "goo," mining equipment and other materials on the creditor's property after rejecting the lease. The creditor brought its adversary proceeding against the debtor claiming $ 23 million in damages for the alleged cost of removing the mess, under theories of waste, nuisance, trespass, and breach of contract. The BAP reversed the bankruptcy court's decision, finding that any damages would have been capped. The appellate court held that the creditor's argument that 11 *U.S.C.S.* § *502(b)(6)* did not cap its claim for damages was properly raised before the court. The creditor did not waive the argument by failing to question the breadth of the § *502(b)(6)* cap in its cross-appeal from the bankruptcy court to the BAP,

as the ruling of the bankruptcy court on this issue was entirely favorable to the creditor. The creditor had no reason to challenge a favorable decision. The appellate court remanded for a determination on the merits of the creditor's claim.

OUTCOME: The appellate court reversed the BAP's decision, and remanded for further proceeding.

COUNSEL: Robert C. Braun, Penelope Parmes and Roger F. Friedman, Rutan & Tucker, LLP, Costa Mesa,California, for the appellant.

Ronald K. Van Wert, Robert K. Van Wert P.C., Costa Mesa, California, and William Malcom, Malcom & Cisneros, Irvine, California, for the appellee.

JUDGES: Before: Daniel M. Friedman,*Alex Kozinski and Ronald M. Gould, Circuit Judges. Opinion by Judge Kozinski.

* The Honorable Daniel M. Friedman, Senior United States Circuit Judge for the Federal Circuit, sitting by designation.

OPINION BY: Alex Kozinski

OPINION

KOZINSKI, Circuit Judge:

Bankruptcy presents a unique challenge: How should a paucity of resources be allocated to cover a multiplicity of claims? Distributing money to satisfy claims is, in most cases, a zero-sum game: Every dollar given to one creditor is a dollar unavailable to satisfy the debt owed to others. For Paul to be paid in full, Peter must be short-changed. Congress sought to balance the interests of competing creditors through an extensive set of rules organizing, prioritizing and structuring [*2] claims against the estate. *E.g.*, 11 *U.S.C.* § *507(a)* (prioritizing claims); *id* § *502(e)(1)* (disallowing claims for reimbursement or contribution); *id* § *502(b)(1)-(5), (7)-(9)* (limiting or disallowing various claims).

The bankruptcy estate of mining company El Toro Materials hopes to use one of these rules--a cap on damages "resulting from the termination of a lease of real property," *id.* § *502(b)(6)--to* limit its liability for allegedly leaving one million tons of its wet clay "goo," mining equipment and other materials on Saddleback Community Church's property after rejecting its lease. Saddleback brought an adversary proceeding against El Toro claiming $23 million in damages for the alleged cost of removing the mess,

under theories of waste, nuisance, trespass and breach of contract. The bankruptcy court, on a motion for partial summary judgment, found that Saddleback's recovery would not be limited by the *section 502(b)(6)* cap. On certified cross-appeal the Bankruptcy Appellate Panel (BAP) reversed, holding that any damages would be capped. Saddleback appeals.

1. The parties entered into a stipulation that the lease would be rejected under 11 *U.S.C.* § *365(a)* (allowing bankrupt tenants [*3] to reject the remaining term of leases).

Claims made by landlords against their bankrupt tenants for lost rent have always been treated differently than other unsecured claims. Prior to 1934, landlords could not recover at all for the loss of rental income they suffered when a bankrupt tenant rejected a long-term lease agreement; future lease payments were considered contingent and thus not provable debts in bankruptcy. *See Manhattan Props., Inc.* v. *Irving Trust Co.*, 291 *U.S. 320,* 332-36, 338, 54 S. *Ct.* 385, *781. Ed.* 824 (1934).

The Great Depression created pressure to reform the system: A wave of bankruptcies left many landlords with broken long-term leases, buildings sitting empty and no way to recover from the estates

of their former tenants. *See Oldden* v. *Tonto Realty Corp.*, 143 *F.2d 916,919-920 (2d Or.* 1944). On the one hand, allowing landlords to make a claim for lost rental income would reduce the harm done to them by a tenant's breach of a long-term lease, especially in a down market when it was difficult or impossible to re-lease the premises. On the other hand, "extravagant claims for ... unearned rent" could quickly deplete the estate, to the detriment of other creditors. *See In re Best Prods. Co.*, 229 *B.R.* 673, 676 *(Bankr. E.D. Va.* 1998). [*4] The solution was compromise in the Bankruptcy Act of 1934 allowing a claim against the bankruptcy estate for back rent to the date of abandonment, plus damages no greater than one year of future rent. *See Oldden*, 143 *F.2d at 920-21.*

Congress dramatically overhauled bankruptcy law when it passed the Bankruptcy Reform Act of 1978. However, *section 502(b)(6)* of the 1978 Act was intended to carry forward existing law allowing limited damages for lost rental income. S. Rep. No. 95-989, at 63 (1978) *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5849 (the cap on damages is "derived from current law"). Only the method of calculating the cap was changed. Under the current Act, the cap limits damages "resulting from the termination of a lease of real property" to "the greater of one year, or 15 percent, not to exceed three

years, of the remaining term of such lease." 11 *U.S.C.* § *502(b)(6).* The damages cap was "designed to compensate the landlord for his loss while not permitting a claim so large (based on a long-term lease) as to prevent other general unsecured creditors from recovering a dividend from the estate." S. Rep. No. 95-989, at 63.

The structure of the cap--measured as a fraction of the [*5] remaining term--suggests that damages other than those based on a loss of future rental income are not subject to the cap. It makes sense to cap damages for lost rental income based on the amount of expected rent: Landlords may have the ability to mitigate their damages by re-leasing or selling the premises, but will suffer injury in proportion to the value of their lost rent in the meantime. In contrast, collateral damages are likely to bear only a weak correlation to the amount of rent: A tenant may cause a lot of damage to a premises leased cheaply, or cause little damage to premises underlying an expensive leasehold. 2

2. Here, El Toro is alleged to have caused $ 23 million of damage to a property that it leased for only $ 28,000 per month.

One major purpose of bankruptcy law is to allow creditors to receive an aliquot share of the estate to

settle their debts. Metering these collateral damages by the amount of the rent would be inconsistent with the goal of providing compensation to each creditor in proportion with what it is owed. Landlords in future cases may have significant claims for both lost rental income and for breach of other provisions of the lease. To limit their recovery [*6] for collateral damages only to a portion of their lost rent would leave landlords in a materially worse position than other creditors. In contrast, capping rent claims but allowing uncapped claims for collateral damage to the rented premises will follow congressional intent by preventing a potentially overwhelming claim for lost rent from draining the estate, 3 while putting landlords on equal footing with other creditors for their collateral claims.

3. The structure of the cap suggests congressional concern about damages from long-term leases spanning many years: The cap maxes out at 15 of 20 years, or 3 years' rent. A claim for lost rent for a full 20 years would in many cases overwhelm any other claims against the estate.

The statutory language supports this interpretation. The cap applies to damages "resulting from" the rejection of the lease. 11 *U.S.C.* § *502(b)(6).* Saddleback's claims for waste, nuisance and trespass do not result from the rejection of the lease--they

result from the pile of dirt allegedly left on the property. Rejection of the lease may or may not have triggered Saddleback's ability to sue for the alleged damages. But the harm to Saddleback's property existed [*7] whether or not the lease was rejected. A simple test reveals whether the damages result from the rejection of the lease: Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it? Here, Saddleback would still have the same claim it brings today had El Toro accepted the lease and committed to finish its term: The pile of dirt would still be allegedly trespassing on Saddleback's land and Saddleback still would have the same basis for its theories of nuisance, waste and breach of contract. The million-ton heap of dirt was not put there by the rejection of the lease--it was put there by the actions and inactions of EI Toro in preparing to turn over the site.

4. We need not, and do not, decide whether Saddleback could have brought its claims before the lease terminated.

5. Our ruling is consistent with *K-4, Inc.* v. *Midway Engineered Wood Prods., Inc. (In re Treesource Indus., Inc.)*, 363 *F.3d* 994 *(9th Cir.*

> *2004)*. There, we determined the priority of a claim for failure to remove materials from the premises, *id. at* 995, whereas today we decide whether similar claims are capped by the [*8] *section 502(b)(6)* limitation. Prioritization of the claim is a separate issue from determining the amount of the claim that will be permitted.

Interpreting the *section 502(b)(6)* cap to include damage collateral to the lease would also create a perverse incentive for tenants to reject their lease in bankruptcy instead of running it out: Rejecting the lease would allow the tenant to cap its liability for any collateral damage to the premises and thus reduce its overall liability, even if staying on the property would otherwise be desirable and preserve the operating value of the business. Bankrupt tenants--especially those who have damaged the property and thus may face liability upon expiration of the lease--would pack up their wares 6 and reject otherwise desirable leases in order to gain the benefit of capping unrelated damages. This would both reduce the operating value of the business and deny recovery to a creditor—a lose-lose situation counter to bankruptcy policy. An incentive to sacrifice efficiency in order to exploit a loophole in the liability-capping provisions would be plainly counter to congressional intent to maximize the

value of the estate to creditors.

6. Or fail to [*9] pack them up at all, as is alleged here.

Further, extending the cap to cover any collateral damage to the premises would allow a post-petition but pre-rejection tenant to cause any amount of damage to the premises--either negligently or intentionally--without fear of liability beyond the cap. If the tenant's debt to the landlord already exceeded the cap then there would be no deterrence against even the most flagrant acts in violation of the lease, possibly even to the point of the tenant burning down the property in a fit of pique. Absent clear statutory language supporting such an absurd result, we cannot suppose that Congress intended it.

The BAP reached a contrary conclusion because it considered itself bound by its precedent in *Kuske* v. *McSheridan (In re McSheridan),* 184 *B.R.* 91 *(B.A.P. 9th Cir.* 1995), and therefore held that Saddleback's recovery against El Toro would be capped under *section 502(b)(6).* 7 To the extent that *McSheridan* holds *section 502(b)(6)* to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenant's failure to complete a lease term, it is overruled. 8

7. Two of the three judges on the appellate [*10] panel filed concurring opinions in which they expressed reservations about *McSheridan,* going as far as to foreshadow that "it may be doubted that *[McSheridan]* ... would survive scrutiny by the court of appeals." *El Toro Materials Co.* v. *Saddleback Valley Cmty. Church (In re El Toro Materials Co.),* No. CC-04-01287, slip op. at 31 (B.A.P. 9th Cir. July 8, 2005) (Klein, J., concurring in result). When the panel believes that one of its precedents is wrongly decided or otherwise deserves reconsideration, the goal of judicial efficiency may be best served by allowing the BAP itself to overrule its own precedent. The BAP, promulgating its rules under supervision of the Ninth Circuit Judicial Council, has not yet implemented a rule creating an en banc procedure. *Cf. Textile Mills Sec. Corp.* v. *Commissioner,* 314 *U.S.* 326,335,62 S. *Ct.* 272, 86 *L. Ed.* 249, 1941-2 *CB. 200* (1941) (statutory authorization for three-judge panels in the courts of appeals did not preclude the Third Circuit from instituting the "more effective" procedure of hearing select cases en banc). As this case suggests, the time may be ripe for the BAP to consider instituting such a procedure.

8. *McSheridan* also holds that damages flowing from the failure [* 11] of a party that has rejected a lease to perform future routine repairs or pay utility bills are capped. 184 *B.R. at* 95, *102.* As the tort claims at issue here are not based on a failure to perform routine maintenance, we do not address the propriety of that holding.

Saddleback's argument that *section 502(b)(6)* does not cap its claim for damages is properly raised before us; Saddleback did not waive the argument by failing to question the breadth of the *section 502(b)(6)* cap in its cross-appeal from the bankruptcy court to the BAP, as the ruling of the bankruptcy court on this issue was entirely favorable to Saddleback. Saddleback had no reason to challenge a favorable decision.

We remand for a determination on the merits of Saddleback's claim.

REVERSED and REMANDED.

NOT FOR PUBLICATION

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL OF THE NINTH CIRCUIT

BAP No. CC-04-1287-PaBK
BAP No. CC-04-1300-PaBK
(cross appeals)

Adv. No. SA 03-01486-RA
Bk. No. SA 02-18913-RA

MEMORANDUM[1]

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[1] This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

In re:
EL TORO MATERIALS COMPANY, INC.,
Debtor.
EL TORO MATERIALS COMPANY, INC.,
Appellant,
v.

SADDELBACK VALLEY COMMUNITY CHURCH; UNITED STATES TRUSTEE; KAREN SUE NAYLOR, Trustee,
Appellees.
Argued and Submitted on February 23, 2005
at Los Angeles, California

Filed - July 8, 2005

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Robert W. Alberts, Bankruptcy Judge, Presiding

Before: PAPPAS[2], BRANDT and KLEIN,
Bankruptcy Judges.

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[2] Hon. Jim D. Pappas, Bankruptcy Judge for the District of Idaho, sitting by designation.

Debtor rejected a real property lease in its chapter 11 case[3].

[3] Absent contrary indication, all section and chapter references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330. "Rule" references are to the Federal Rules of Bankruptcy Procedure, and "FRCP" references are to the Federal Rules of Civil Procedure.

The lessor filed a proof of claim for $23 million in damages. Through an adversary proceeding, Debtor objected to the lessor's claim and sought to recover money damages from the lessor for its alleged prepetition breach of the lease. The lessor asserted counterclaims under several different theories, including nuisance, waste, and trespass, all premised upon the same conduct by Debtor.

On Debtor's motion for partial summary judgment, the bankruptcy court decided that the lessor's claims for nuisance and waste were not subject to the cap on a lessor's claim for breach damages under 11 U.S.C. § 502(b) (6). It also dismissed the lessor's trespass claim. Debtor timely appealed the bankruptcy court's application of § 502(b) (6), and the lessor cross-appealed dismissal of its trespass counterclaim.

We REVERSE the decisions of the bankruptcy court and REMAND.

I. FACTS

As early as the 1960s, the predecessor-in-interest to Debtor El Toro Materials Co., Inc. ("El Toro") conducted sand and gravel mining operations on leased property in Orange County, California. By the late 1970s, El Toro took over control of the operation.

The leased property was owned, at least as of the 1980s, by Baker Ranch Properties ("Baker Ranch"). On November 1, 1988, Baker Ranch and El Toro executed a lease agreement with a term of ten years and seven months. This lengthy document comprehensively detailed El Toro's rights and duties as to the leased property. Among the terms relevant to this appeal, the lease provided:

> [ARTICLE] 9.01 Throughout the term of this Lease, El Toro, at its sole cost and expense, shall promptly comply with all present and future laws, ordinances, orders, rules, regulations and requirements of all federal, state, county and municipal governments, departments, commissions, boards and offices, including, but not limited to the conditions set forth in all existing permits.
>
> [ARTICLE] 10.01 El Toro shall have the right to use the Premises only for the following:
>
> (a) Subject to the conditions set forth in all applicable government permits, the removal from the Premises of rock, sand, gravel, and fill materials . . . .
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> (e) The storage of materials procured from or off the Premises which are used in conjunction

with [the permitted mining operations described in the lease].

[ARTICLE] 10.05 As additional consideration for [Baker Ranch] entering into this Lease, EI Toro shall conduct all of its operations in a workmanlike manner in accordance with sound engineering and mining principals and practice, though Lessor hereby acknowledges that EI Toro does not have an engineer on the Premises at all times, and consistent with the reshaping of the Premises as follows:

(a) The Premises shall be restored to as near as practical with the grade as outlined in EI Toro's Reclamation Plan granted by the County of Orange . . . and the finished grade as set forth in EI Toro's Grading Permit ... or as said Grading Permit is later amended with the written consent of Lessor.

(c) All settlement ponds and debris deposits will be removed from the Premises prior to the termination of the term, except as same are necessary to complete El Toro's operations within the term of the Lease, which remaining ponds and deposits shall be removed no later than four (4) months following the date of termination.

ARTICLE 23 SURRENDER - END OF THE TERM

> On the expiration or other termination of the term of this Lease . . . El Toro shall quit and surrender the Premises to Lessor, in good order and condition, as set forth in Section 10.05 hereinabove, free and clear of lettings, subtenancies and occupancies and of all liens and encumbrances other than those if any, created by lessor.

El Toro and Baker Ranch executed an amendment to the lease on the same day they executed the lease. This amendment provided Baker Ranch with the right to bifurcate the lease into two separate leases in connection with a division of the property into two separate lots and a sale or transfer of either lot. The amendment. further specified that, upon bifurcation of the property into Plots 1 and 2, the lease would continue in effect with the fee owners of either plot.

On June 20, 1997, appellee Saddleback Valley Community Church ("SVCC") and El Toro executed a conditional amendment to El Toro's 1988 lease with Baker Ranch in anticipation of SVCC's purchase of Plot 1. At the time, SVCC owned other property adjoining the Baker Ranch property. One of the proposed modifications between SVCC and El Toro

extended. El Toro's lease term indefinitely, subject to termination by either party upon two years' notice. SVCC purchased Plot 1 (approximately forty acres) from Baker Ranch in 1999, and in December 2001 it gave El Toro notice of its intent to terminate the lease.

Prior to the lease expiring under the two-year notice provision of the modification agreement, on October 18, 2002, SVCC gave El Toro a "Thirty (30) Day Notice to Perform or Quit." This notice alleges that El Toro had violated Articles 9.01 and 23 of the 1988 lease by stockpiling waste material generated in its sand mining operation. SVCC demanded that El Toro remove or dispose of the waste material within thirty days, vacate Plot 1, or face legal action.

El Toro filed for protection under chapter 11 of the Bankruptcy Code on November 18, 2002[4]. SVCC filed a proof of claim for $23 million in El Toro's bankruptcy case. According to the proof of claim, the basis for SVCC's claim is that E1 Toro stockpiled approximately 650,000 cubic yards of mining byproducts on its property; the amount of the claim was derived from cost estimates SVCC received to

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[4] A chapter 11 trustee was appointed in the Chapter 11 case on October 1, 2003. However, the record does not disclose the circumstances precipitating this event, nor do the parties suggest they are relevant to the appeal or cross-appeal.

remove the waste material[5]. SVCC's claim also references unspecified future damage it may incur due to delays in its ability to develop Plot 1, and the possibility of subsequently amending its proof of claim to assert an administrative claim for El Toro's postpetition "unauthorized operations . . . and the delay in the development" of Plot 1.

On January 24, 2003, El Toro and SVCC filed a stipulation in the bankruptcy case. This stipulation provided El Toro would reject the lease, effective upon the bankruptcy court's order approving the stipulation, but remain in possession of Plot 1 until April 30, 2003. El Toro was required to pay rent during this extension, which allowed it to make a

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[5] At oral argument, counsel for El Toro represented that the waste material at issue is not a "hazardous material." It is, counsel suggests, "fill" material. While SVCC refers to the stockpile in its briefing as "goo," or more specifically, as water-saturated clay resulting from El Toro's sand-washing operation, rubble and debris, we presume the nature of the material is not particularly pertinent to the issues on appeal, but rather, it is the existence of and amount in the stockpile that concern SVCC.

In addition, we note SVCC's dispute with El Toro also involved, at least initially, certain equipment and other personal property El Toro left behind on Plot 1. Counsel for El Toro informed the Panel that the trustee had sold these items prior to oral argument. Presumably, that sale effectively settled any dispute regarding the equipment, and so the Panel will focus only on the stockpiled material, as have the parties.

more orderly departure. The bankruptcy court entered an order approving the stipulation on January 27, 2003. El Toro vacated the premises on the designated date but did not remove the residue.

El Toro objected to SVCC's claim, and *it* filed a complaint against SVCC on April 25, 2003, initiating the adversary proceeding from which this appeal and cross-appeal arise. The bankruptcy court consolidated El Toro's objection to SVCC's proof of claim and the adversary proceeding *in* an order dated October 24, 2003.

In its complaint, El Toro alleged, inter alia, that SVCC breached the lease agreement and interfered with El Toro's relationship with its subtenants and with its plan to shift its operation to Plot 2. SVCC answered and asserted counterclaims against El Toro for, as relevant to this appeal, breach of the lease, and state law claims for waste, nuisance, and trespass.

All four of SVCC's counterclaims were premised, in whole or in part, on El Toro's stockpiling of mining byproducts on Plot 1. In particular, the trespass claim focused on El Toro's postpetition, post-rejection failure to remove the stockpiled mining waste. Specific to this claim, SVCC identified its damages as including the cost of removing the

stockpiled material and restoring Plot 1 as detailed in a reclamation plan. In its prayer for relief, SVCC also requested that the bankruptcy court issue an injunction requiring El Toro to remove the mining waste and any other property it had left behind on the leased property.

On November 3, 2004, El Toro filed a motion for partial summary adjudication in which it asked the bankruptcy court to apply the § 502(b) (6)[6] cap on

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[6] This Code provision states that, upon objection to a claim, the bankruptcy court

shall determine the amount of such claim as of the date of the filing of the petition, and shall allow such claim in lawful currency of the United States in such amount, except to the extent that-

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds-

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of-

(i) the date of the filing of the petition; and
(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates[.]

claims of a lessor for damages to both SVCC's proof of claim and to its counterclaims in the adversary proceeding; to dismiss SVCC's counterclaim for interference with prospective economic advantage; and to dismiss SVCC's request for injunctive relief requiring it to remove the mining waste.

In its opposition papers, SVCC made a number of arguments, including one urging that its trespass claim should not be dismissed. El Toro filed a reply brief, and in a footnote, it argued that since El Toro was in rightful possession of Plot 1 prior to lease rejection, it could not be liable for trespass.

The bankruptcy court granted El Toro's motion in part. It held:

> (1) All of SVCC's claims for damage due to the Debtor's nonperformance under the lease, including damages for breach of the lease covenants, are limited by the cap in § 502{b) (6) of the bankruptcy Code as damages resulting from "termination" of the subject lease.
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> (2) However, SVCC's claims for damages arising from "tortious illegal acts (specifically, those for nuisance and waste)" are not limited by the cap.

(3) Debtor's motion for partial summary judgment was granted as to SVCC's counterclaim for trespass.

(4) Debtor's motion for partial summary judgment was granted as to SVCC's claim for injunctive relief.

Although the judgment did not dispose of all of the claims raised in the adversary proceeding, the bankruptcy court certified it as a final order pursuant to FRCP 54(b), applicable via Rule 7054.

After the bankruptcy court denied their respective motions for reconsideration, El Toro and SVCC each timely appealed the judgment. El Toro seeks review of the bankruptcy court's decision concerning application of the § 502(b) (6) cap; SVCC appeals dismissal of its trespass claim[7].

II. JURISDICTION

The bankruptcy court had jurisdiction via 28

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[7] As the two appeals were identified as cross-appeals, the BAP clerk issued a cross-appeal ;briefing schedule, with which the parties have complied. On January 31, 2005, EI Toro filed an "Additional Citation of a Relevant Decision" with a cite to K-4, Inc. v. Midway Engineered Wood Prods .. Inc. (In re Treesource Indus. Inc.),363 F.3d 994 (9th Cir. 2004).

U.S.C. § 1334 and § 157(b) (1) and (b) (2) (B). We have jurisdiction on appeal under 28 U.S.C. § 158(c).

III. ISSUES

A. Whether the bankruptcy court erred in concluding that SVCC's counterclaims against El Toro under state law for waste and nuisance, premised upon conduct by El Toro that also constituted a breach the parties' lease agreement, were not subject to the damage cap in § 502(b) (6).

B. Whether the bankruptcy court erred *in* granting summary judgment to El Toro dismissing SVCC's counterclaim for trespass.

IV. STANDARD OF REVIEW

The Panel reviews the grant or denial of summary judgment de novo. Prestige Ltd. P'ship-Concord v. E. Bay Car Wash Partners (In re Prestige Ltd. P'ship-Concord), 234 F.3d 1108, 1114 (9th Cir. 2000) (addressing denial of summary judgment); Captain 18 Blythers, Inc. v. Thompson (In re Captain Blythers. Inc.), 311 19 B.R. 530, 534 (9th Cir. BAP 2004) (addressing grant of summary judgment). Viewing the evidence in the light most favorable to the nonmoving party, the Panel must determine whether there are any genuine issues of material fact and whether the trial court correctly applied

relevant substantive law. In re Captain Blythers, Inc., 311 B.R. at 534. The bankruptcy court's interpretation of the Bankruptcy Code is also reviewed de novo. Id.

V. DISCUSSION

A. Does the § 502(b) (6) cap limit damages resulting from a debtor's conduct that violates the terms of the lease, but is also actionable under state tort law?

Because SVCC's nuisance and waste claims are based upon El Toro's failure to remove the mining residue from the leased property, conduct that SVCC in its proof of claim concedes constitutes a violation of the lease, we conclude that the § 502(b) (6) cap on a lessor's damages applies. Our conclusion is based upon the language of the Bankruptcy Code, the interpretations previously given this provision by this Panel, and, importantly, is required by the critical undisputed facts of this case.

1. The Language of the Code.

As always, our examination of the scope of the statutory cap on damage claims begins with the words of the statute. The critical language here is that part of § 502(b) (6) that applies a cap to "the claim of 'a lessor for damages resulting from the

termination of a lease of real property . . . ."

This language is simple enough and is not ambiguous. The Code applies the cap to a lessor's claim for "damages." The words in the statute do not distinguish between a lessor's claims founded upon contract, tort, statute or some other legal basis. If the lessor holds a claim for "damages," the claim is capped. All kinds of damages claims are logically included within the reach of the cap. As a result, under a plain reading of the statute, there is no reason to infer a limitation on the type of damages a lessor may recover under the statute.

It is also significant that later, in the same subsection of the Code, in constructing the formula for calculating the amount of the cap in each case, Congress refers to "the rent reserved" and to "any unpaid rent." 11 U.S.C. § 502(b) (6) (A), (B). See Koons Buick Pontiac GMC, Inc. v. Nigh, 125 S. Ct. 460, 466-67 (2004) (instructing that statutory construction is a "holistic endeavor" and that perceived ambiguity may be clarified by reading one statute in the light of the remainder of the statutory scheme). By using these more specific terms, presumably Congress intended there be a difference between rendering all the lessor's "damages," which are subject to the cap, and those kinds of damages used to calculate the actual amount of the cap in

each case, using a formula based on "rent." See Kuske v. McSheridan (In re McSheridan), 184 B.R. 91, 96-100 (9th Cir. BAP 1995) (establishing a three-part test for determining which components of a lessor's claim constitute "rent reserved" for purposes of § 502(b) (6) (A). We must assume that if Congress intended that the reach of the cap be limited solely to claims for "rent," or that the nature of the damage claim be limited at all, Congress would have expressly said so in the statute.

Instead, the only limitation in the damage cap is that the lessor's claim be one resulting from the termination of a lease." In other words, to come within the cap, the lessee's failure to perform the lease must be the "cause in fact" of the lessor's damages. This language requiring a causal connection between the lessee's conduct and the lessor's damages does not require that the damages be based on breach of the lease, nor does it exclude damages claimed for state common law torts based upon the debtor's conduct in violating the lease, if that conduct in fact caused the damages.

A broad reading of the scope of the cap on lessor damages is consistent with its purpose. As the Panel has previously observed, the statutory limit on a lessor's claim was intended by Congress to "[prevent] landlords from receiving a windfall as a result of the

filing of the bankruptcy petition [by the lessee]." McSheridan, 184 B.R. at 97. Indeed, the cap reflects a balancing of interests struck by Congress by allowing a lessor "to be paid a reasonable sum without unfairly diluting or squeezing out other creditors." Redback Networks, Inc. v. Mayan Networks Corp. (In 12 re Mayan Networks Corp.), 306 B.R. 295, 306 (9th Cir. BAP 2004) (Klein, J., concurring).

Obviously, the cap becomes important only when a lessor's damages recoverable under state law exceed the amount of the cap as calculated under the statute[8]. When it operates, the cap effectively denies

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[8] Given the procedural status of this action, it would be speculative for the Panel to assume SVCC will prevail on the merits of its claims against El Toro. The issue here is, assuming SVCC holds valid claims against El Toro under its different theories, whether the amount of those claims would be capped. We are somewhat concerned that we are asked to decide an issue of law that may, or may not, be implicated in the final analysis. We acknowledge, though, SVCC's proof of claim alleges El Toro owes it "in excess of $23 million," an amount that would clearly exceed any cap calculated under §502(b) (6). Therefore, resolving the legal question as to the applicability of § 502(b) (6) to SVCC's counterclaims will materially aid the bankruptcy court on remand. In addition, we understand the bankruptcy court has certified its decision as a final judgment under FRCP 54(b), applicable here via Rule 7054. See Dawson v. Washington Mut. Bank (In re Dawson), 390 F.3d 1139, 1145-46 (9th Cir. 2004) (considering similar factors in assessing appellate jurisdiction).

a landlord payment of a claim otherwise enforceable under state law. But the § 502(b) (6) cap is not remarkable in that regard. Through many provisions of the Code[9], Congress has decided which creditor claims are to be paid, or not, in bankruptcy cases, or as in this case, how much creditors can recover. In adopting the § 502(b) (6) cap, Congress has exercised its judgment about the policies embodied in the Code. Because policy is implicated, the bankruptcy courts, in enforcing the Code, cannot appropriately alter the outcome, even if the results in a particular case may seem harsh. See Lamie v. United States Tr., 540 U.S. 526, 542 (2004).

In summary, the language of § 506(b) (6) cannot be read to exclude from the scope of the lessor's damages cap claims based on state tort law when the same conduct giving rise to those claims also amounts to a breach of the lease.

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[9] See, e.g., 11 U.S.C. §§ 502(b) (7) (capping the claim of an employee for damages resulting from the termination of an employment contract); 502(e) (1) (disallowing claims for reimbursement or contribution under certain conditions); 507(a) (3) (capping the amount of apriority claim for wages, salaries, or commissions) (to be re-codified as§ S07(a) (4) under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 212, 119 Stat. 23, 51).

1. BAP Precedent.

The decisional law in this Circuit also counsels against any attempts to limit the broad scope of § 502(b) (6). In 1995, in a thoughtful analysis, the panel in McSheridan gave us clear guidance concerning the scope of the § 502(b) (6) cap. In that case, the BAP was asked to decide whether, upon rejection of a commercial real property lease in a bankruptcy case, a lessor's claims for unpaid utilities, repair and maintenance costs, expenses for replacement of an air conditioning system and the roof of the leased premises, and for insurance costs, all came within the cap. Although these were all charges that the lease required the lessee to bear, because they were not "rent reserved," the debtors objected to allowance of the lessor's claim. To resolve the dispute, the panel was required to decide whether these sorts of charges came within the scope of the §502(b) (6) cap, and if so, how the amount of the cap should be calculated. The panel concluded that all the expenses claimed by the lessor came within the cap, and remanded the case to the bankruptcy court to decide, under a new test developed by the panel, the amount of the cap.

Admittedly, in McSheridan, the lessor did not argue, nor did the panel address, whether the tenant had committed one or more torts. Nor was there any

claim made by the lessor in that case that the costs it sought to recover resulted from the debtor's violation of local government environmental or land-use regulations or ordinances. Instead, the lessor claimed the costs could be recovered based upon the lease.

Because of this, it may be tempting to distinguish, or putting it more bluntly, to disregard, the panel's decision as dicta in the face of the facts and arguments made in this appeal. It would be unwise, however, to read McSheridan so narrowly. In resolving the issues, the McSheridan panel decided how to interpret the same provisions of § 502 (b)(6) that are at issue here. Its interpretive approach was essential to its holding. And in its reading of the Code, the McSheridan panel rejected the very same interpretation offered, and authorities cited, by SVCC.

> More specifically, the McSheridan panel discussed the decision of the bankruptcy court in In re Atlantic Container Corp., 133 B.R. 980 (Bankr. N.D. Ill. 1991), a decision relied upon by the lessor in this case. In Atlantic Container, the bankruptcy court held that a lessor's claim for repair and maintenance costs under the lease resulting from the lessee's physical neglect and damage to the leased property was not capped by

> § 502(b)(6) because the phrase "damages resulting from the termination of the lease" does not seem to contemplate the type of damages being sought here. The phrase suggests that § 502(b)(6) is intended to limit only those damages which the lessor would have avoided but for the lease termination. Any damages caused to the Premises by the Debtor's failure to fulfill its repair and maintenance obligations are unrelated to the termination of the lease.

McSheridan, 184 B.R. at 100 (quoting Atlantic Container Corp., 16 133 B.R. at 987). Because the damages caused by the lessee to the leased premises in Atlantic Container were not "prospective" and "had nothing to do with the long-term nature of the lease," the bankruptcy court concluded the cap should not apply.

McSheridan also carefully considered the bankruptcy court's decision in In re Bob's Sea Ray Boats, Inc., 143 B.R. 229 (Bankr. 22 D.N.D. 1992). There, the lessor sought to recover not only unpaid rent, but asserted claims 'for damages inflicted on the premises by the lessee-debtor, and for the lessee's wrongful removal of light fixtures from the leased property's parking lot. Relying upon Atlantic Container, the bankruptcy court refused to apply the

§ 502(b) (6) cap to the claims for damage to the premises and removal of the lights because the cap "does not address damages wholly collateral to the termination event-such things as waste, destruction or removal of leasehold property." 143 B.R. at 231.

The McSheridan panel declined to follow the approach of Atlantic Container Corp. or Bob's Sea Ray Boats. Instead, the panel opted for a broad interpretation of the scope of the cap. It noted that a broad cap fulfills the purpose of discharging the debtor from suits based upon violation of the lease and fixes the liability of the lessee. McSheridan, 184 B.R. at 101. The panel also noted that § 502(b) (6) must be read in concert with other provisions of the Code, including § 365(d) (3) (requiring the debtor to perform a lease only until it is assumed or rejected), 13 § 365(g) (deeming rejection a breach of the lease), and § 502(g) (providing that a lease rejection claim is to be treated as a prepetition claim). Doing so, the panel observed:

> [R]ejection of the lease results in the breach of each and every provision of the lease, including covenants, and § 502(b) (6) is intended to limit the lessor's damages resulting from that rejection. The damages are those resulting from nonperformance of the debtor's obligations under the lease.

184 B.R.102[10].

The holding in McSheridan was not limited to its facts, nor did it depend upon the precise type of, damages being asserted by the lessor. Fairly read, the holding of McSheridan was, as [the § 502 (b) (6) cap]." Id. To accept SVCC's arguments in this case, which are founded upon the same cases considered and rejected by the panel, would imply a limitation not found in the language of the Code, and it would require us to modify the McSheridan approach to interpreting this statute, which we are unwilling to do. As McSheridan made clear, "all damages" flowing from the debtor-lessee's conduct constituting "nonperformance" of the lease are capped by § 506(b) (6).

2. The Undisputed Material Facts.

Finally, the facts of this appeal compel reversal of the bankruptcy court's grant of summary judgment to SVCC concerning the damages cap. Though SVCC

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[10] In a slightly different context, Judge Klein has expressed that § 502 (b) (6) "is not ambiguous when one considers interrelated provisions [of the Code]" and that "[w]hat looks like ambiguity when § 502(b) (6) is viewed in isolation is clarified by other Bankruptcy Code provisions." In re Mayan Networks Corp., 306 B.R. at 303-04 (Klein, J., concurring).

has invited us to do so, we cannot ignore these important undisputed facts. When they are considered, it becomes clear that any claims that SVCC could assert for damages for nuisance or waste based on El Toro's conduct in this case would also constitute a breach of the covenants of the parties' lease.

Before discussing those facts, it is important to recognize an issue we need not decide - whether there could ever be a situation in which a lessor should be allowed to assert a state law tort claim against its lessee that would be excluded from the § 502(b) (6) cap. In this regard, the analogies offered by SVCC in its briefing are inapt. This is not a case, as SVCC's approach suggests, where one party commits an intentional tort (or even a crime) against another while those parties, as a matter of coincidence, occupy the status of tenant and landlord. Those are not our facts.

Here, we need only determine whether a lessor's claim for damages caused by a lessee's acts, which acts also constitute a breach of its lease, should be excluded from the reach of the § 502(b) (6) cap, simply because those same acts may constitute a state law tort, or because those acts also violate a state or local regulation or ordinance. When the issue is properly framed, it is apparent that if the

cap is not applied, SVCC will succeed in a classic end-run around the will of Congress.

It is undisputed that El Toro (or its predecessor) had occupied and used the property in question since the 1960's, most recently pursuant to a 1988 written real property lease with SVCC's predecessor. That lengthy document comprehensively details El Toro's rights and duties as to the leased property. It is also important to recognize it was a long-term lease; its original term would not have expired until 1999. And in connection with SVCC's acquisition of the property, SVCC and El Toro agreed to extend the term of the lease indefinitely and to allow that it could be terminated only upon two years' notice.

Some of the lease terms that are critical in this appeal include:

-El Toro was allowed by the lease to mine and remove rock, sand, gravel and fill materials from the land. This provision contemplated that El Toro would wash sand from excavated materials, a process that created the "goo", "residue" or "debris" involved in this case.

- Incident to its operations, El Toro was authorized by the lease to store materials it mined from the land on the leased premises. Fairly read,

this provision authorizes El Toro to stockpile the residue.

- El Toro committed to remove "debris deposits" from the leased premises "no later than four (4) months following the date of termination [of the lease]." This provision reflects the parties' understanding that, upon termination of the lease, there may be stockpiles of residue remaining on the leased premises.

- In conducting its business operations on the leased property, El Toro promised to comply with all applicable federal, state and local laws, regulations and ordinances.

- And El Toro agreed to restore the grade of the leased premises, and to "rehabilitate" the property, so as to comply with a reclamation plan that had been approved by the county.

SVCC did not succeed to the lessor's interest under the lease until 1997. In other words, EI Toro had been operating under the terms of the lease, mining material from the leased land, washing out saleable sand, and producing and storing residue clay on the property, for nearly a decade prior to SVCC's succession to Baker Ranch's interest under the El Toro lease. SVCC was presumably aware and

approved of the nature of El Toro's operations, since in connection with acquiring the lease, SVCC agreed to an indefinite extension of the lease with El Toro. El Toro apparently continued in its use of the property in this fashion for several years after SVCC became its neighbor and landlord.

It was not until October 2002 that SVCC gave El Toro a written notice that it intended to forfeit the lease. In that notice, SVCC alleged that El Toro had breached the lease. In particular, SVCC relied upon provisions of the lease requiring EI Toro to comply with local laws, ordinances and regulations, and it contended EI Toro had failed to do so because certain local laws allegedly required it to "regularly remove" the clay residue it was stockpiling on the property. SVCC also alleged in the notice that El Toro breached the lease terms requiring it to restore the property to conditions described in the county's reclamation plan, although the lease provides that this duty does not arise until expiration or termination of the lease.

El Toro's response to SVCC's notice was to seek chapter 11 relief, and in that bankruptcy case, to reject the lease. In its proof of claim, SVCC recites the same lease provisions referenced in the notice it had given to EI Toro, and alleges its damages are based upon breach of the lease. It seeks recovery of

in excess of $23 million to "[remove] the debris and deleterious material stockpiled by the debtor in violation of the permits, Reclamation Plan, and Lease ...."[11]

Based upon this record, it appears clear that SVCC's *claim* is based upon El Toro's storage of, and failure to remove, the residue from the leased premises, allegedly in violation of county rules and ordinances. Nor is there any question, at least in SVCC's view, that El Toro's conduct is expressly prohibited by the various provisions of the parties' lease cited above.[12]

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[11] There, is no indication in the, record that SVCC has ever amended its proof of claim to show that, in addition to breach o the lease, SVCC seeks to recover against El Toro for state law torts or for EI Toro's violations of' local law. Apparently the first mention in the bankruptcy court record of SVCC's contention that it is asserting claims for other than breach of the lease is in SVCC's answer and amended counterclaim filed in the adversary proceeding from which this appeal originated.

[12] It is disconcerting. that SVCC, which purchased adjoining property and the lessor's ownership interest more than ten years after El Toro began its business on the leased land, could recover, years later, under state' tort law for El Toro's continuing activities. It is also unclear whether SVCC, as a private party, has standing to enforce state or local mining laws and regulations. The bankruptcy court rejected El Toro's standing arguments because it failed to provide legal support for them. Although the court's reaction to such a lackadaisical approach is understandable, on remand the bankruptcy court *is* reminded that "federal courts are under an independent

Again, contrary to SVCC's assertions, this is not a case involving a lessee's commission of a tort against another person who, coincidentally, happens to be the tortfeasor's landlord. Instead, the facts more closely resemble the Atlantic Container and Bob's Sea Ray Boats cases, where the debtor-lessee had committed lease violations (such as neglecting the premises, or "stealing" light fixtures) that may have also given rise to state law tort claims for nuisance, waste, trespass, and although not alleged here, perhaps conversion.

Simply put, the undisputed facts in this appeal show the same conduct that SVCC alleges constitutes nuisance and waste in this case also constitutes a breach of the lease.

4. Based upon the statute, case law, and facts of this case, the damage cap in § 502(b) (6) applies to SVCC's counterclaims arising under state tort law.

El Toro's rejection of the lease in its bankruptcy case is deemed as a matter of bankruptcy law to constitute a breach of that lease immediately before

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obligation to examine their own jurisdiction, and standing 'is perhaps the most important of [the jurisdictional] doctrines." FW/PBS. Inc. v. City of Dallas, 493 U.S. 215, 231 (1990) (quoting Allen v. Wright, 468 U.S. 737, 750 (1984)).

the date of the filing of the petition. 11 U.S.C. § 365(g) (1). As a result, SVCC's claim against EI Toro for failure to remove the residue stockpile is a prepetition claim. 11 U.S.C. § 502(g); K-4, Inc. v. Midway Engineered Wood Prods., Inc. (In re Treesource Indus., Inc.), 363 F.3d 994, 998 (9th Cir. 2004).

The § 502(b) (6) damage cap should apply because SVCC's claim against EI Toro for its alleged failure to comply with local laws and to remove the residue stockpile is one for damages resulting from El Toro's rejection *(i.e.*, the breach) of the lease. That El Toro's acts may also give rise to claims by SVCC founded on state law tort does not matter.

The language of § 502(b) (6) is broad and includes all claims by a lessor for "damages," provided those claims result from termination of the lease. Sound precedent from this panel instructs that the lease cap applies to all damages flowing from a breach of the covenants of a lease, and not just to claims for unpaid "rent." That same case law rejects the approach taken by other courts, and invoked by SVCC here, that the cap does not apply to "collateral" claims for infliction of damages to the leased premises or for conversion of. Leasehold improvements and furnishings. And finally, the notice SVCC gave to El Toro, and the proof of claim

filed in El Toro's bankruptcy case, both establish that SVCC's claim *is* for conduct constituting a breach of the lease.

The bankruptcy court erred when it decided that any claims SVCC can assert for nuisance or waste under state law are excepted from the § 502(b) (6) cap. We reverse that decision.

B. Did the bankruptcy court err in dismissing SVCC's trespass claim?

SVCC argues in its cross-appeal that the bankruptcy court erred procedurally in dismissing its counterclaim for trespass. It complains that El Toro did not request such relief in its motion and the issue was raised so late in the proceedings that it did not have adequate notice its trespass claim had been called into question. Alternatively, SVCC argues the bankruptcy court misapplied the law regarding the merits of its trespass action.

1. Did the court commit procedural error?

A trial court generally may not grant summary judgment on a claim when a party has not requested it, Kelly v. Arriba Soft 14 Corp., 336 F.3d 811, 822 (9th Cir. 2003), unless the opposing party has had a full and fair opportunity to ventilate the issues

involved in the motion. United States v. Grayson, 879 F.2d 620, 625 (9th Cir. 1989). In this case, SVCC requested injunctive relief to remedy El Toro's alleged trespass based on El Toro's post-rejection failure to remove the residue. El Toro moved for summary judgment arguing equitable relief was not available to SVCC, a contention which surely put the trespass claim in the spotlight. Apparently SVCC perceived that El Toro's motion for summary judgment placed its trespass claim in jeopardy because, in its opposition papers, SVCC argued its trespass claim should proceed to trial. Apparently, SVCC's contentions prompted El Toro to include in its reply brief a more direct attack on the substance of the trespass claim, as opposed to just the remedy sought, albeit in a footnote.

On this record, we are persuaded that the bankruptcy court afforded SVCC a "full and fair opportunity to ventilate" its position before it ruled on the validity of SVCC's trespass claim. SVCC submitted to the court its arguments why its trespass claim should be allowed to go forward. Since SVCC was fairly heard, the bankruptcy court did not commit a procedural error in granting summary judgment.

2. Did the bankruptcy court incorrectly apply state law?

The bankruptcy court did not discuss its basis for dismissing SVCC's trespass claim. Rather, it simply agreed with El Toro's contention that "trespass will not lie under the facts of this case." El Toro had argued that because it had been in rightful possession of the property prior to termination of the lease, it could not be liable for trespass under California law because its actions were not "an invasion of the interest in the exclusive possession of land," citing Capogeannis v. Superior Court, 15 Cal. Rptr. 2d 796, 799 (1993). SVCC contends that El Toro's post-rejection failure to remove the residue and equipment constitutes a wrongful occupation of Plot 1, and that the bankruptcy court erred in summarily dismissing its trespass claim because the uncontroverted evidence established trespass. In the alternative, SVCC argues that there are issues of material fact with respect to this cause of action.

Trespass is "an unlawful interference with the possession of property." Mangini v. Aeroiet-Gen.Corp., 281 Cal. Rptr. 827, 837 (Cal. Ct. App. 1991).

> A trespass may be committed by the continued presence on the land of a structure, chattel, or

> other thing which the actor or his predecessor in legal interest has placed on the land (a) with the consent of the person then in possession of the land, if the actor fails to remove it after the consent has been effectively terminated, or (b) pursuant to a privilege conferred on the actor irrespective of the possessor's consent, if the actor fails to remove it after the privilege has been terminated, by the accomplishment of its purpose or otherwise.

Restatement (Second) of Torts§ 160 (1965). See also Mangini, 281 Cal. Rptr. at 837. California case law supports the proposition that a holdover tenant may be liable to a landlord for trespass. Fracomeno v. Ins. Co. of the W., 255 Cal. Rptr. 111, 115-17 (Cal. Ct. App. 1989), overruled on other grounds by Vandenberg v. Superior Court, 88 Cal. Rptr. 2d 366 (Cal. 1999); Peter Kiewit Sons' Co. v. Richmond Redevelopment Agency, 223 Cal. Rptr. 728, 734 (Cal. Ct. App. 1986); Stephens v. Perry, 184 Cal. Rptr. 701, 706 n.4 (Cal. Ct. App. 1982).

In light of these authorities, that El Toro was in lawful possession of Plot 1 prior to termination of the lease does not necessarily preclude SVCC's trespass claim targeting El Toro's failure to remove its property (i.e., the "goo") when it surrendered the

premises. In this respect, the bankruptcy court's dismissal of the trespass claim was erroneous and must be reversed.

On remand, the bankruptcy court must also address several questions we do not reach. Of course, while SVCC may proceed on its trespass counterclaim, we express no opinion on the merits of that claim. Moreover, if SVCC prevails on more than one of its counterclaims, the bankruptcy court, prior to applying the § 502(b) (6) cap, may be required to analyze the damages available to SVCC under each theory and to reconcile the result in light of the prohibition under California law against double recovery. See McCall v. Four Star Music Co., 59 Cal. Rptr. 2d 829, 831 (Cal. Ct. App. 1996) (discussing rule against double recovery); Stoiber v. Honeychuck, 162 Cal. Rptr. 194, 209 (Cal. Ct. App. 1980).

And the parties have raised yet another issue that we cannot fully resolve. El Toro argues that California law prohibits a party from recovering in tort if the allegedly tortious conduct is covered by the terms of a contract (i.e., a lease). As a general principle, El Toro's argument correctly reflects the law. JRS Prods., v. Inc. v. Matsushita Elec. Corp. of Am., 8 Cal. Rptr. 3d 840, 849 (Cal. Ct. App. 2004) ("a party to a contract cannot recover damages in tort for breach of contract"). But the same conduct that

constitutes breach of a contract may also amount to an actionable tort if the conduct violates a duty that is independent of the contract and arises from principles of tort law. Erlich v. Menezes, 981 P.2d 978, 983 (Cal. 1999). Because the bankruptcy court did not reach this issue, we will not address it either.

However, while the trespass claim must be remanded for trial, it is proper on this record for us to conclude that if SVCC prevails in recovering an award of money damages against El Toro,[13] any damages awarded to SVCC would be subject to the cap in § 502(b) (6). This conclusion results from the analysis above regarding SVCC's counterclaims for nuisance and waste. Because SVCC's trespass claim against El Toro stems from the lessee's failure to remove the stockpile at lease termination, a clear violation of the terms of the parties' lease, the cap applies.

And even though El Toro's alleged failure to remove the residue results from its conduct during the bankruptcy case, SVCC's trespass damages would nonetheless constitute a nonadministrative, prepetition claim. In Treesource Indus., the Ninth

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[13] This presumes SVCC forgoes its' claim for equitable relief since SVCC did not appeal the bankruptcy court's ruling that it is not entitled to an injunction because it has an adequate remedy at law.

Circuit addressed whether a lessor's claim for the debtor/lessee's failure to restore leased property to its pre-lease condition upon termination should be considered a prepetition or postpetition claim. 363 F.3d at 995-96 (considering administrative expense priority under § 503). The lease required the debtor to remove, upon termination, all improvements it made during the term of the lease, including footings, floors, and foundations, and to regrade the land to its natural contours. *Id.* at 996. The debtor failed to remove a concrete slab upon rejection of the lease. Although the lessor in Treesource Indus. did not assert a trespass claim, the court provided a straightforward analysis. Because the debtor's obligation to restore the leased property was triggered, under the terms of the lease, upon its "termination or expiration," and because the debtor's rejection of the lease terminated it, the lessor's claim for the debtor's failure to remove the concrete slab was a prepetition claim. *Id.* at 998.

That same logic applies with equal force to the facts here. El Toro's obligation to vacate Plot 1 and restore the property as detailed in the reclamation plan was triggered, under ARTICLE 23, upon the lease's expiration or termination. El Toro's rejection of the lease terminated it. The termination gave rise to El Toro's obligation to remove the mining waste, a corollary of which is El Toro's liability under state

trespass law for its failure to do so. Viewed this way, any harm SVCC suffers as a result of the stockpiled waste, regardless of the legal theory employed, is a result of the termination of the lease, is a prepetition claim, and is therefore subject to the damage cap in § 502(b) (6).

VI. CONCLUSION

The bankruptcy court erred in deciding that SVCC's nuisance and waste claims were not limited by the cap on lease termination damages in § 506(b) (6). The bankruptcy court also erred by dismissing SVCC's trespass claim. The decision of the bankruptcy court is REVERSED and this adversary proceeding is REMANDED to the bankruptcy court for further proceedings consistent with this opinion.

BRANDT, Bankruptcy Judge, concurring:

Confined by our prior authority, In re McSheridan, 184 B.R. 91 (9th Cir. BAP 1995), I reluctantly concur, but I find the reasoning of In re Atlantic container Corp., 133 B.R. 980 (Bankr. 25 N. D. Ill. 1991) and In re Bob's Sea Ray Boats, Inc., 143 B.R. 229 (Bankr. D.N.D. 1992), more persuasive.

I disagree that the language of the statute is plain, and in this case, the result is potentially very

harsh. Further, it is perverse: to enforce tenants' guarantees of lease obligations other than those ordinarily understood by business folk to be "rent" in state proceedings, or security for those guarantees, a lease must make breaches of those obligations defaults. But then if the tenant becomes a debtor in bankruptcy, an expansive interpretation of the cap of 11 U.S.C. § 506(c) vitiates the perfectly reasonable protections so bargained for. It is also ironic that, were El Toro a trespasser, SVCC's claim would not be limited by the cap. Finally, I see no principled distinction between violations of covenants to comply with environmental laws and violation of covenants not to engage in tortious or criminal conduct - all of those obligations arise independently of the landlord-tenant relationship.

Were I free to follow the contrary authority, I would do so.

KLEIN, Bankruptcy Judge, concurring in result:

I reluctantly concur in the result and share Judge Brandt's concerns. My doubts are substantive and procedural.

I assume, for purposes of analysis, that McSheridan controls, even though that decision did not deal with a bargained-for restore-the-premises post-expiration obligation. Our McSheridan panel

dealt with how to determine whether particular expenses, not expressly denominated as "rent," nevertheless qualified as "rent reserved by" a so-called "triple net" lease and rejected arguments that non-rent expenses might be recovered on a tort theory.

A

While I agree that re-branding contractual obligations as "torts" is not a promising strategy for eluding the § 502(b) (6) cap, thinking about the problem head-on as a matter of contract gives pause.

I am not confident that a bargained-for contractual restore-the-premises obligation following the end of a lease by either expiration or termination is necessarily subsumed by § 502(b) (6). It may, instead, be an independently cognizable obligation. The language of the statute appears to include a causation requirement linked to termination of a lease ("damages resulting from the termination of a lease of real property"). A contractual restore-the-premises obligation that applies regardless of whether the lease terminates or merely expires arguably is an obligation that does not "result from" termination.

As noted in the majority opinion, the § 502(b) (6) cap reflects a balancing of interests struck by Congress by allowing a lessor a reasonable sum without unfairly diluting or squeezing out other creditors by virtue of the common-law measure of damages that permits a landlord to obtain, subject to a duty of mitigation, the full balance of rent owed under the lease. In a functional sense, the cap amounts to a conclusive presumption, as between landlord and estate, that the landlord will have fully mitigated all future lost-rent damages once it receives the amount of the cap.

A restore-the-premises obligation does not fit comfortably within either the language or the policy of § 502(b) (6). Hence, it may be doubted that the second half of the McSheridan analysis, which appears to say that all sums owed pursuant to a lease contract following lease termination are subsumed by the capped rent *claim*, would survive scrutiny by the court of appeals. McSheridan, 184 B.R. at 100-02.

If the lease had expired by its terms before the bankruptcy case was filed, it is doubtful that § 502(b) (6) would cap the full restoration obligation under a lease contract. Similarly, if the lease were to expire by its terms within one year after the filing of the petition, it is not clear that the cap would impair the

contractual restoration obligation. If these doubts are meritorious, then it arguably ought not to matter that the lease was terminated prematurely.

B

As a matter of procedure, the trial court's certification of finality pursuant to Federal Rule of Civil Procedure 54(b), as incorporated by Federal Rule of Bankruptcy Procedure 7054(a), directing entry of judgment makes the judgment that was rendered on partial summary judgment final and immediately appealable. 28 U.S.C. § 158 (a) (1).

Nevertheless, there *is* reason for caution. This appeal appears to be inextricably intertwined with numerous other as-yet unresolved facets of the larger dispute between the parties. It appears that, in reality, it was the landlord who did the terminating. Each party continues to have *claims* against the other. There may be issues of setoff and other complications that add up to create a settlement imperative.

The consequence of all this is that, while we must exercise jurisdiction, the circumstances are inherently interlocutory. Our ruling may be more advisory than definitive. I am reluctant to make definitive determinations in speculative

circumstances about a very complex problem.
Hence, I CONCUR IN THE RESULT.

U.S. Bankruptcy Appellate Panel of the Ninth Circuit
125 South Grand Avenue, Pasadena, California 91105
Appeals from Central California (626) 229-7220
Appeals from all other Districts (626) 229-7225

NOTICE OF ENTRY OF JUDGMENT

BAP No. CC-04-1287-PaBK and CC-04-1300-PaBK (cross-appeals)

RE: EL TORO MATERIALS COMPANY, INC.

A separate Judgment was entered in this case on July 8, 2005.

BILL OF COSTS:

Bankruptcy Rule 8014 provides that costs on appeal shall be taxed by the Clerk of the Bankruptcy Court. Cost bills should be filed with the Clerk of the Bankruptcy Court from which the appeal was taken. 9th Cir. BAP Rule 8014-1

ISSUANCE OF THE MANDATE:

The mandate, a certified copy of the judgment sent to the Clerk of the Bankruptcy Court from which the

appeal was taken, will be issued 7 days after the expiration of the time for filing a petition for rehearing unless such a petition is filed or the time is shortened or enlarged by order. See Federal Rule of Appellate Procedure 41.

APPEAL TO COURT OF APPEALS:

An appeal to the Ninth Circuit Court of Appeals is initiated by filing a notice of appeal with the Clerk of this Panel. The Notice of Appeal should be accompanied by payment of the $255 filing fee (effective November 1, 2003) and a copy of the order or decision on appeal. Checks may be made payable to the U.S. Court of Appeals for the Ninth Circuit. See Federal Rules of Appellate Procedure 6 and the corresponding Rules of the United States Court of Appeals for the Ninth Circuit for specific time requirements.

CERTIFICATE OF MAILING

The undersigned, deputy clerk of the U.S. Bankruptcy Appellate Panel of the Ninth Circuit, hereby certifies that a copy of the document on which this certificate appears was mailed this date to all parties of record to this appeal.

By: Patti Ippolito
Deputy Clerk: July 8, 2005

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In Re	)
	)
EL TORO MATERIALS COMPANY, INC.	)
	)
Debtor(s) .	)
	)
	)
EL TORO MATERIALS COMPANY, INC.	)
Plaintiff (s),	)
	)
vs.	)
	)
	)
	)
	)
	)
SADDLEBACK VALLEY COMMUNITY	)
CHURCH,	)
Defendant(s)	)
	)
----------	)
	)
SADDLEBACK VALLEY COMMUNITY	)
CHURCH,	)
	)
Counterclaimant	)
	)

vs.)
)
EL TORO MATERIALS COMPANY, INC.)
)
Counterdefendant)
)
)

No. SA 02-18913 RA

Adv. SA 03-01486

Chapter 11

MEMORANDUM OF OPINION ON DEBTOR'S MOTION FOR PARTIAL SUMMARY ADJUDICATION

Date: 12/9/03
Time: 11:30 A.M.
Place: Courtroom 6C

The Debtor in this case, El Toro Materials, Inc. (hereinafter "the debtor") is in the business of processing arid selling sand and gravel. Prior to the filing of the petition, the debtor was the tenant under a lease with Baker Ranch Properties wherein the debtor leased land from Baker Ranch Properties

for the purpose of conducting mining operations and processing mining materials. Saddleback Valley Community Church (hereinafter "SVCC") succeeded Baker Ranch Properties in April, 1999. On November 18, 2003, the debtor filed its voluntary petition under chapter 11 with this court and two months thereafter entered into a stipulation with SVCC rejecting the aforementioned lease. In addition to rejecting the lease, the stipulation also provided that the debtor would be allowed to remain on the property for an additional three months. Pursuant to the stipulation, the debtor's continued occupancy of the property was conditioned upon the debtor's deposit of three months rent into an escrow account and upon SVCC being paid from the escrow account on the first day of each month that the debtor remained in possession of the property. On March 23, 2003, SVCC filed a claim for $23,000,000. The debtor objected to the claim and filed this adversary action against SVCC. SVCC filed an answer and a counterclaim. The objection to the claim, the action by the debtor and counterclaim of SVCC have been consolidated by this court. In its claim and counterclaim, SVCC asserts that it was damaged by the debtor's failure to perform certain reclamation and restoration obligations required under state and local law. It is the debtor's position that since the terms of the lease provided that they had an ongoing obligation to comply with all laws,

permits and its reclamation plan, any damage claim stemming from any injury caused by the debtor to the leased premises prior to the termination or rejection of the lease between the debtor and SVCC, is subject to the cap (the "cap") under section 502(b)(6) of the Bankruptcy Code. (11 U.S.C. 502(b)(6)

[FN1] Consequently, the debtor has filed a motion for partial summary adjudication seeking a judgment which limits SVCC's claim and counterclaim to the damages to which a landlord is entitled under the cap.

> [FN1]: § 502. Allowance of claims or interests provides (b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—
>
> ...(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds--
> (A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15

percent, not to exceed three years, of the remaining term of such lease, following the earlier of-- .
(i) the date ofthe filing ofthe petition; and
(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property;
plus
(B) any unpaid rent due under such lease, without acceleration, on the earlier
of such dates;

The debtor relies heavily on the 9th Circuit Bankruptcy Appellate Panel (the "BAP") decision in In re McSheridan, 184 B.R. 91 (9th Cir. BAP 1995). In the McSheridan case, the panel ruled, in effect, that all damages due to debtor tenant's nonperformance, including damages for breach of lease covenants, are limited by the cap and within the scope of damages resulting from "termination" of the real property lease. In re McSheridan, 184 B.R. 91, 102 (9th Cir. BAP 1995).

The decisions of the BAP are binding precedent for this court. In re Proudfoot 144 RR.876, (9th Cir. BAP 1992); In re Ball 185 B.R. 595 (9th Cir. BAP 1995). Accordingly, even though there is a split among courts regarding what damage claims of the lessor are limited by the cap (see In re Atlantic Container Corp. 133 BR 980 (Bankr. N.D. Ill 1991);

In re Bob's Sea Ray Boats, Inc. 16 143 BR 229 (bankr. D.N.D. 1992) and even though this court does not necessarily agree with the holding in re McSheridan, this court concludes that case is binding precedent in this case. Therefore, all of SVCC's claims for damages due to the debtor's nonperformance under the lease in this case, including damages for breach of lease covenants, are limited by the cap as damages resulting from "termination" of the subject lease. However, it is this court's opinion that damages arising from tortious or illegal acts are not damages resulting from the termination of the lease. Such tort claims (specifically, those for nuisance and waste) are not based upon the lease and therefore are not within the scope of the cap. This court does, however, agree with the debtor that trespass will not lie under the facts of this case.

In its motion for partial summary adjudication the debtor also requests that this court find as a matter of law that SVCC is precluded from obtaining an order compelling the debtor to perform any of its obligations under the lease, in that SVCC's sole remedy is an action for damages. Once a lease has been rejected, the debtor is excused from performance under the lease. "Generally, the bankruptcy court may order the bankrupt's estate either to assume or reject any executory contract or unexpired lease, subject to its approval. 11 U.S.C. §

365(d)(2). Assumption assures the continuation in force of the contract or lease. However, it requires the trustee or debtor-in-possession to cure all past defaults and to offer adequate assurance of future performance. Rejection allows the bankrupt's estate to avoid those requirements and limits the non-bankrupt obligee to an unsecured claim for breach of contract. After rejection, the performance of the non-bankrupt obligee is excused." In re Pacific Exp. Inc. 780 F.2d 1482 (9th Cir. 1986) The Supreme Court in Ohio v. Kovacs, 469 U.S. 274 (1985) held that an injunction directing the cleanup of a hazardous waste site gave rise to no more than a general, unsecured claim. Accordingly, since the debtor's performance under the lease has been excused in this case, and since SVCC has an adequate remedy at law, an injunction at this time would be inappropriate.

The debtor contends that SVCC does not have standing to bring suit to enforce provisions of permits that have been issued to the debtor by local governmental agencies or maintain a private cause of action under the California Surface Mining and Reclamation Act of 1975 (SMARA) and that these actions must be initiated by a governmental agency. However, the debtor cited no authority to that effect and thus, the motion is denied re such claims.

The debtor asks this court to find as a matter of law that SVCC may not maintain its action a against the debtor for interference with prospective economic advantage where there is no evidence that the debtor had knowledge of any existing or prospective economic relationship between SVCC and any third party or that the debtor did any wrongful act to interfere with any such potential economic relationship. SVCC contends that summary adjudication would be premature at this time and requests additional time to develop its case. SVCC states that it "... intends to commence discovery regarding its claims in the near future." "Where party will have the burden of proof on an element essential to its case at trial and does not, after adequate time for discovery, make a showing sufficient to establish the existence of that element, there can be no genuine issue as to any material fact since a complete failure of proof concerning an essential element of the nonmovant's case necessarily renders all other facts immaterial:' Celotex Com v. Catrett 477 U.S. 317 (1986). SVCC's counterclaim was filed in August of 2003. Nearly seven months have gone by. There has been adequate time for discovery and still SVCC makes no showing to establish the existence of any evidence to support its counterclaim. Accordingly, the debtor is entitled to judgment as to such counterclaim.

Finally, the court concludes there is no just reason for delay, and entry of the judgment in accordance with this opinion shall be [mal pursuant to FRCP 54(b) [FN2], made applicable by FRBP 7054. Debtor's attorneys are to serve and lodge a proposed judgment accordingly and this adversary proceeding shall proceed as to the remaining issues.

DATED: 3/12/04
ROBERT W. ALBERTS
Bankruptcy Judge

[FN2] FRCP 54(b) states: Judgment Upon Multiple Claims or Involving Multiple Parties. When more than one claim for relief is presented in an action, whether as a claim, counterclaim, cross-claim, or third-party claim, or when multiple parties are involved, the court may direct the entry of a final judgment as to one or more but fewer than all of the claims at: parties only upon an express determination that there is no just reason for delay and upon an express direction for the entry of judgment. In the absence of such determination and direction, any order or other form of decision, however designated, which adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order or other form of decision is subject to revision at any time

before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA

In Re	)
	)
EL TORO MATERIALS COMPANY, INC.	)
	)
Debtor (s) .	)
	)
EL TORO MATERIALS COMPANY, INC.	)
Plaintiff(s),	)
	)
vs.	)
	)
SADDLEBACK VALLEY COMMUNITY CHURCH,	)
	)
Defendant(s) .	)
	)
SADDLEBACK VALLEY COMMUNITY CHURCH,	)
	)
Counterclaimant	)
	)
vs.	)
	)
EL TORO MATERIALS COMPANY, INC.	)
	)
Counterdefendant	)

The Debtor's Motion for Partial Summary Adjudication having come on regularly for hearing before the undersigned bankruptcy judge at the time and place set forth above; and appearances having then been made by parties in interest as stated on the record in open Court, and the Court being fully advised in the premises, for the reasons stated by the undersigned in the Memorandum of Opinion on Debtor's Motion for Partial Summary Adjudication filed on March 12, 2004, it is

ORDERED, ADJUDGED AND DECREED that the motion is granted in part and denied in part as follows:

(1) All of Saddleback Valley Community Church's claims for damage due to the debtor's nonperformance under the lease in this case, including damages for breach of lease covenants, are limited by the "Cap" in Section 502(b)(6) of the Bankruptcy Code as damages resulting from "termination" of the subject lease.

(2) Saddleback Valley Community Church's claims for damages arising from tortious or illegal acts (specifically, those for nuisance and waste) are not limited by the "cap" in Section 502(b)(6) of the Bankruptcy Code.

(3) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure ~~in favor of Debtor~~ with regard to Saddleback Valley Community Church's counter, claim for Trespass.

(4) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure ~~in favor of Debtor~~ with regard to Saddleback Valley Community Church's claim for injunctive relief.

(5) Debtor's Motion for Partial Summary Adjudication is denied with respect to Debtor's claim that Saddleback Valley Community Church lacks standing to bring suit to enforce the provisions of permits issued to the Debtor by governmental agencies or to maintain a private cause of action under the California Surface Mining and Reclamation Act of 1975.

(6) Debtor's Motion for Partial Summary Adjudication is granted pursuant to Rule 56 of the Federal Rules of Civil Procedure ~~in favor Debtor~~ with regard to Saddleback Valley Community Church's claim for Interference with Prospective Economic Advantage.

(7) The adversary proceeding shall proceed as to all remaining issues.

DATED: 4/20/04

ROBERT W. ALBERTS